

MODERN BUSINESS



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AND FIRST EDITOR-IN-CHIEF

OF THE

MODERN BUSINESS SERIES

Real Estate

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In collaboration with

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Alexander Hamilton Institute
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PREFACE

THE development of business on an ever-enlarging scale, with its requirement of more spacious housing, has accentuated, as in no previous period, the real estate problems incidental to the conduct of commerce and industry. The management of the company's properties has taken on a new and, at times, a critical importance. The executive's success in finding the right location for his factory or his store may be the prime factor in winning a permanent foothold; a mistake in location may lead to defeat or bankruptcy.

The exercise of sound judgment in real estate matters is dependent upon extensive knowledge. The business man who knows real estate values will forecast correctly, and anticipate profitably, the trends of city growth. He will forecast and anticipate, also, the future demands of his business for adequate housing. When the time for expansion arrives, he will have put himself, by a judicious anticipatory leasing or buying of space, in a position to take advantage of the new opportunities.

Whether the business man handles the transactions himself, or turns them over to a real estate specialist, it behooves him to be well acquainted with the nature

of the problems that will arise in the multitudinous details incidental to the transfer or acquisition of property, including title searching, the drawing up of contracts, deeds, and leases, the execution of mortgages, and the like. If the business undertakes to erect its own building, new problems arise in planning and layout, in construction, and in financing the structure. When completed, the building must be serviced and managed.

The complexity of these problems will vary from one business to another, but their relative complexity or simplicity does not make them any less urgent. Moreover, real estate problems have a tendency to reassert themselves; no business can feel assured that its location is permanent or that its space requirements have been set definitely and finally.

It is for the purpose of assisting the business executive correctly to envisage and study such problems that this Text has been written. To follow through the real estate activities of the average business, and to discuss the questions of procedure and policy arising from these activities, has been the plan adopted by the authors.

An excellent combination of progressive theory and practical experience has been brought to the writing of this Text by the author and his collaborator. C. Elliott Smith is Assistant Professor of Finance in the School of Commerce, Accounts, and Finance of New York University, a contributing editor to the *Real Estate Record and Builder's*

Guide, and a member of the New York Real Estate Board. From practical experience in the West as a broker and in the East as a member of the real estate department of a chain-store organization, Professor Smith has obtained a first-hand acquaintance with real estate problems in both sections of the United States.

Harry Hall is chairman of the board of Wm. A. White & Sons, of New York City, and may fairly be called the dean of the real estate profession in that city. During his thirty and more years of service, he has originated or sponsored many of the progressive practices now everywhere accepted in building management and real estate brokerage. Mr. Hall is also responsible for planning the real estate courses at Columbia University, and was in charge of real estate education there for some time.

A valuable contribution of facts on Canadian real estate practice and law has been made by R. W. Hart, of Parker, Clark & Hart, Barristers and Solicitors, of Toronto, who carefully read the entire manuscript.

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REAL ESTATE

CHAPTER I

RELATION OF REAL ESTATE TO BUSINESS

1. *Importance of real estate to business.*—Real estate is the foundation upon which is built the whole structure of man's economic and social existence. Land is the source of all material wealth. It is the habitat of nations. From the land come the natural resources that flow into the manufacturing processes, thus furnishing the commodities that help to satisfy human wants. Commerce in real estate is, and probably will continue to be, the largest business in the world. Its practice requires technical training and experience peculiar to its requirements, and has made the real estate man a special member of the business community. To the average business man, in fact, real estate practice seems distinctly apart from his ordinary concerns.

Nevertheless, whether the business man rents or owns his place of business or factory, he is vitally concerned with the subject of real estate. A location for the business, a place in which to carry on its activities, is a prime consideration from the moment an

organization is founded. Real estate is often the most valuable and the most stable asset of the business. It is not the land itself, however, but the location of the land, and the use to which it can be put, that represent the actual element of value. The use, in turn, depends primarily upon the physical characteristics of the land and its relation to centers of population.

2. *Effect of business activity on real estate.*—The vast growth of business in recent years, especially since 1915, together with the curtailment of construction programs during the war, resulted in a dearth of factory and office buildings suited to modern needs. With the removal of restriction on building operations in 1919, a vast construction program, outstripping all previous records, was launched throughout the country. This building program has been both extensive and intensive. Not only have bigger sites been involved, but the building units constructed have been increasingly larger, and the tendency toward huge industrial and office buildings has not yet reached its peak.

Real estate requirements have passed beyond the period of small properties. There is an increase, not only in the height of buildings and in the number of stories constructed, but also in the ground area covered. The building 50 or even 100 by 100 feet is no longer the economic unit in large cities. In fact, the architects in metropolitan centers are considering the block as the economic unit and, in the case of office

buildings, 100 stories as a possible limit. Industrial buildings a third of a mile or more in length are not unusual in suburban or country regions.



Montgomery Street skyline in San Francisco's financial district, illustrating the concentration of real estate values in a modern business area.

The increase in size of buildings has resulted in a management problem that is distinct from the problem of buying, leasing, or selling real estate. This problem involves the task of maintaining, operating, and managing the property. It has become more complicated as property has become more valuable and more extensive. The management of such huge

structures as the Equitable, the Lincoln, or the Chrysler buildings has become a business within a business. It is a responsibility requiring unusual skill and technical training.

3. *Importance of value.*—The most fundamental knowledge that the business man should possess on real estate matters is an understanding of the basic principles of value and of methods for the accurate appraisal of real estate. The executive is not, nor is he likely to become, an expert appraiser, but he should develop a sense of values, and acquire a grasp of appraisal procedures sufficient for ordinary purposes. Without such an understanding of real estate valuation, the business man will be less likely to know when the price asked for a piece of real estate is too much, or when he is being offered a bargain. Furthermore, since he rents more frequently than buys, an understanding of the procedures in valuing leaseholds is very important to him.

The basic principles of value are presented in Chapter III. The accepted methods of appraising property are described in Chapters IV and V. An appraisal work sheet for industrial property is given in Chapter V. This form, which can be used by anyone in appraising industrial properties, simplifies the process by providing a place for listing every factor affecting the value of the property.

4. *The real estate problem.*—From a practical standpoint, the chief real estate problem of the business man is obtaining a suitable location for his

enterprise. If the business is that of manufacturing a product, the factory must be convenient to sources of raw materials, near an adequate supply of labor, accessible to the market, and served by adequate means of transportation. In some cases suitable houses for workers must be provided in close proximity to the factory. Large industries in isolated localities have sometimes found it necessary to build up towns for their employees.

If the business is that of distributing rather than fabricating a product, the problem then is to provide warehouses, showrooms, stores, and executive offices convenient to buyers and to the shopping public. Banks, trust companies, insurance companies, real estate concerns, and professional organizations all have the common problem as to where they shall locate and how they shall manage the real estate over which they have control.

5. *Financing*.—The problem of financing is closely related to the major real estate problem of the business. As soon as the matter of choosing a location comes up, the executive must prepare to finance the acquisition of the site. If property is to be purchased, a part of the cost can be raised by mortgaging it. Blanket mortgage bonds may be sold, debentures may be issued, or recourse may be had to second and purchase-money mortgages.

If the business is being expanded out of earnings so that stock can be sold, this relieves the executive of the necessity of mortgaging the property. If the

property is to be leased, the problem of financing its acquisition is greatly simplified. As a general rule, it is good business policy to rent rather than buy. If property is purchased, it is usually wise to reduce the investment in property to a minimum by obtaining as large a mortgage as possible. Exceptions to these general rules will be discussed in Chapter VI.

6. *The difficulty of choosing a suitable location.*—The hit-or-miss method of choosing a suitable location no longer suffices. For a retail store, one side of the street may be good, the other poor. One of four corners may be the place where the trade will center, while the other three may provide little patronage. The side street may be an excellent location for one type of store, the avenue the best for a higher class establishment. One location for a particular business may be worth \$50,000 a year, while the same space two blocks away may not be worth \$2,500 a year. The factory is not faced with the problem of securing a good location from the standpoint of retail selling, but must consider such items as obtaining railroad sidings, convenient roadways for trucking, good transportation for its employees, and similar facilities.

7. *Business expansion and real estate.*—In many cases it is necessary to provide increased operating area for the expansion of the particular business. Some time ago, one of the largest banking houses in America increased its office space by taking a long-term lease in an adjoining building, and breaking a



By Ewing Galloway, N. Y.
Lower Manhattan skylines in 1886 and in 1930. The square tower of the N. Y. Produce Exchange is the only structure visible in both views. St. Paul's and Trinity are completely hidden in 1930.

doorway through, thus gaining the use of several floors in that building. At the same time another banking house, that was using a ground floor and three upper floors in another building, found that it was unable to lease additional space in the building. Its quarters were inadequate, so it bought and moved into a six-story building several blocks away. This arrangement did not prove to be convenient, and the bank was later forced to erect a building of its own in another location.

Contrasted with the above method of providing for expansion is the policy followed by one of the largest public utility corporations in the country. This particular company estimates the normal increase of its business for a period of ten to twenty-five years in advance. When a building is constructed, it is designed to take care of this expansion, even though in the early years of the period part of the space is leased to outside firms for office purposes. Railroads, manufacturing concerns, telephone and telegraph companies, chain stores, banks, and many other business concerns are adopting this policy of planning for expansion. Such a plan gives adequate space for current needs, ample space for expansion, and an investment that, in most cases, yields a substantial income.

8. *Relocating the business.*—When the residential section of a city moves outward, business must follow in its wake to keep the shopping sections closer to the customers. Likewise, when new transportation

facilities are developed, new and more suitable locations for business come into existence around terminals and stations. Not so many years ago, one of the largest department stores in a western city found that the fashionable shopping district was moving to another part of the city. When the movement started, there was no definite indication as to just where the center of the new district would be. The store management, therefore, decided that the best policy to follow would be to get options on several strategic sites in the new area and await developments. This plan was followed. When the lease expired on the old property, the store was in a position to buy a new site, and had completed its plans for its new building. A competing department store, in the older shopping section of this same city, held to the idea that its reputation had been established and its trade built up in the downtown section, and that customers would continue to patronize the store at its old location. This assumption turned out to be a vain hope and the store has since gone out of business.

9. *The building problem.*—If no suitable building exists on a new property that is acquired, the purchase of the site is followed by the construction of a building. The solution of the building problem calls for the exercise of good judgment, backed by a certain amount of knowledge of real estate economics, finance, architecture, and building construction methods.

If the company does not own the property but merely leases it, the owner of the land may agree in some cases to put up a building to suit the tenant. The whole construction problem is then shifted to the landlord. But this plan does not relieve the business man of the responsibility of choosing the type of building to be constructed, not only from the standpoint of design and floor plan, but also from that of service features and special appointments. A large sign on the front of an old four-story "taxpayer," stated, "This Will Be Your Building." In other words, the landlord was willing to build a four-story building to suit a responsible tenant, and to let the tenant choose the name for the building, provided the tenant would sign a long-term lease at a mutually agreeable rental.

However, if the company is called upon to erect its own building, the business man enters upon a new rôle in his contact with real estate brokers, lawyers, architects, contractors, subcontractors and material-supply men. He must know what services each can render. A decision must be reached whether to deal directly with subcontractors and material men, or through a general contractor. The relative liability to the business, in each case, from the standpoint of contracts and of workmen's compensation must be determined. A selection of the type of building best suited to the purpose must be made. The floor plan and service facilities must be laid out. The details of the financing plan must be developed, and the con-

struction of the building justified from the investment standpoint.

The alteration problem is very similar to the building problem. In this case, also, the solution depends upon whether the landlord is making the alterations, or whether the concern itself will be called upon to do so. Business policy may enter into the question, depending in part upon the term that the lease has to run. For example, a high-class specialty shop having a short-term lease could not readily afford to make extensive alterations, even though it might be good business policy to have a more elaborate establishment.

In making alterations to buildings, it is necessary to call upon the services of the architect, contractor, subcontractor, and material-supply men. The contract for alterations must be carefully drawn up. It is an important instrument and the basis of all of the relationships arising between the company and the contractors and material men.

10. *Insurance*.—The problem of risk-bearing exists in every business and in nearly every branch of a particular business. It is the duty of the business executive to recognize and to guard against the risks of real estate ownership, just as he provides against losses in other phases of the business. It is not unusual, even in these times of general appreciation of insurance, to hear of some business that has been ruined because it did not carry fire insurance, or because it did not carry insurance to cover an injury

occurring to someone in or about the building. With this general warning in mind, a chapter has been devoted to the risks of property ownership, and to a description of the various kinds of insurance that may be taken out.

11. *Taxation*.—Taxes, to most people, are something to be paid and forgotten about, after making every effort to reduce them to a minimum. While this attitude may be typical of human nature, it is not constructive, and it cannot safely be transferred to business practice. Particularly is this true for the business organization seeking a new location, and having under consideration a number of attractive sites. The tax rate, under such circumstances, may become a vital matter.

A study should be made of the tax systems of the states in which the desirable properties are located, and of the tax rate in the particular cities or towns under consideration. In New York State, for example, there are two first-class industrial towns within fifty miles of each other that have radically different tax rates. In one town, the property is assessed at approximately 110 per cent of its fair market value, and the tax rate is at the legal maximum. In the other, taxes are about fifty cents per hundred dollars lower, and property is assessed at only 92 per cent of the fair market value. Since real property taxes amount to about 30 per cent of the net rental that can be derived from real estate, they represent an item to be watched very carefully.

Many states are dispensing with real property taxes, thus giving the business-owned property in those particular states an advantage. The tendency now is to reduce or to eliminate real estate taxes and to introduce the income tax or a series of special levies. Many civic bodies, real estate boards, and groups of business men have done everything within their power to obtain tax reductions. Such bodies have accurate information on tax burdens and will help the business man in finding a location in a low tax area.

12. *The necessity for knowledge of real estate matters.*—At first, it might seem that the real estate problems of the business are simple, because they involve only the providing of a suitable location for the company. However, the problem is not always so easy to solve. Every real estate transaction, whether large or small, has its ramifications in law, finance, economics, and business policy. The business man, to be successful in handling the real estate affairs of his company, must be well informed, must know when to employ the services of a lawyer or a real estate expert, and when to rely upon his own knowledge and judgment. He must at least be familiar with good real estate practice, and must have sufficient knowledge of principles to be able to formulate wise policies. These qualifications are necessary to enable him to deal intelligently with real estate brokers and to make decisions that safeguard adequately the best interests of his business.

Dealing in and managing real estate is, after all, a rather technical problem. It is so surrounded and hedged in by legal restrictions that the average layman is soon bewildered by the large number of difficulties confronting him.

13. *Importance of apparently small details.*—The following examples illustrate the importance of even a small detail affecting real estate. A capable restaurant manager recently leased, for five years, with the option of renewal at an advanced rental, the ground floor of a building located in a good residential section. He had the place redecorated, spending about \$20,000 for this work and new equipment. The restaurant opened in impressive style and was doing a flourishing business, when the owner was told that the street was zoned for residential purposes only. What could he do? Nothing but move out, and seek a location that could be used for a restaurant. He lost not only the money spent in establishing the business, but also the income that he had to forego until he could find a new location. All would have been well, if it were not for one small but most important detail—a zoning regulation.

Another rather interesting incident occurred in downtown New York some time ago. A plot had been assembled for the purpose of constructing a building. After all of the parcels had been acquired, the owner found that he did not have title to a strip one inch wide by 100 feet deep. The lending institutions refused to grant the loan until the title had been

cleared up. The result was a substantial loss in time and money to the owner, all because of a very slight error in a survey which had been made over a hundred years ago. Such occurrences emphasize the importance of care, and the necessity for training in real estate matters, so that what appears to be only a detail does not escape notice and come up later to wreck the real estate plans of the business.

14. *Methods of handling real estate.*—There are four methods of handling the real estate matters incidental to conducting the business. If the activities are not extensive, the most logical method is through, or by, some officer of the company. If the real estate activities of the business are extensive, three alternative methods may be used. First, a real estate department may be formed, under the direction of a vice-president or other officer of the business, to handle real estate exclusively. Second, the services of an agency and management firm may be employed. Third, a separate corporation may be formed for the purpose of holding and managing the company's real estate.

The choice of a method for handling real estate matters will depend upon the circumstances in the particular business. One of the chain-store organizations, with extensive real estate holdings, for many years handled all of its real estate activities through the president, who was by training a real estate broker. Later, it became necessary to develop a staff to assist the president. Then a real estate depart-

ment was established. Finally, several separate corporations were formed to carry on this work.

15. *Business policy and real estate.*—The extent of the real estate activities of a business are governed, partly by the character of the business, and partly by policies of the management regarding real estate. For example, a bank needs suitable quarters. The policy of the board may be to rent the necessary space under a long-term lease. The policy of another bank in the same city, however, may be to buy or erect a building, using the ground floor for banking purposes and renting out the upper floors. Thus two identical real estate problems are solved in two ways, primarily on the basis of policy. Similar examples could be given in nearly every field of business.

The question arises as to the kind and extent of knowledge the business man should have at his finger tips to assist him in matters concerning real estate, and how much background in real estate theory he must build up to season his judgment in matters of real estate policy. The answer to this question develops as the various phases of the real estate problems of the business man unfold.

16. *Speculation in real estate.*—One of the first rules of business that affects the acquisition of real estate may be expressed in the statement that speculation in real estate is not a function of the business.

Business is conducted for the purpose of engaging in a certain industrial or commercial pursuit. It

follows, as an implied power, that a business corporation can own property for its own use. This may involve the construction of a building, and it is sometimes desirable for a corporation to acquire more property than is needed for immediate use in anticipation of future use. But it is an *ultra vires* act for a business corporation to go into the buying and selling of real estate for a profit.

Speculation in real estate by a business corporation is not only an *ultra vires* act, but it is inexpedient from the business standpoint, since such a policy takes funds away from the legitimate operation of the business and ties them up in real estate. If a business corporation wants to speculate or operate in real estate, a separate real estate company should be formed for that purpose.

REVIEW

Explain how a knowledge of real estate values, and of methods of appraising, will help the business man in solving his real estate problem.

What problems arise in choosing a location for the business?

Describe the methods that may be used in handling real estate.

Show how business policy may affect the real estate activities of a concern.

Should the business man speculate in real estate? Give your reasons.

NOTE.—The reviews throughout this Volume are for the personal convenience of the reader in testing his understanding of the chapter. It is not necessary or desirable for subscribers to submit written answers to the Institute except in a case where they may feel uncertain as to their grasp of the question under consideration.

CHAPTER II

HANDLING THE REAL ESTATE AFFAIRS OF THE BUSINESS

1. *The importance of real estate matters.*—The real estate of the business represents, in most cases, a permanent investment. Because the property is usually acquired as a permanent location for the company, the utmost care should be exercised in selecting the site and in handling every detail of the real estate transactions. A mistake may have a far-reaching effect on the business. An ill-chosen site, or a property that involves too heavy a financial load, may prove to be a millstone dragging the business down to disaster. Many business failures are the direct result of too high rents or too expensive buildings. Rent and the fixed charges on the property are uncontrollable expenses. It is a serious matter to assume the responsibility of paying a fixed rental over a long period of years, or of meeting the carrying charges on an expensive building, unless the business is sound and profitable and the location promises to maintain its advantages or to improve them.

One of the ambitions of many men is to leave a monument to their success in the form of a beautiful

building to house the business that they have built up by extraordinary effort. Such an ambition, unless financially sound, may prove the undoing of the business. The Woolworth building, in New York, is an asset as well as a business memorial, but the Citizens' Bank building at Hocom, Missouri, may be a liability. Many a beautiful marble building, the pride of the town, is a white elephant on the hands of its owners. If the life history of the governor of one of our western states could be written in its true light, the biographer would tell the story of a man who put his all into an unfortunate building venture. The fruits of a life's efforts were put into a monumental edifice that was to house the carefully planned and carefully managed business. The building was a failure, financially, and the governor was ruined. He did not know enough about real estate to foresee his error. He was a good business man, but a poor judge of real estate.

2. *Choosing a method for handling real estate.*—One of the first problems to be settled with regard to the real estate holdings of the business is the choice of a form of organization or a method of holding and managing the real estate. As outlined in Chapter I, there are four common methods, namely: through the president or some other officer of the business; through a real estate department; through real estate brokers; or in the name of, and through, separate real estate corporations. The choice of one, or a combination of one or more, of these methods

will depend upon several factors, some inherent in the business itself, some developing as the result of personnel, and some developing as the result of business policy.

At the start of a business, the method adopted, as a general rule, will not be an actual choice but merely an expedient, utilizing the most convenient method. Business concerns seldom have definite real estate policies outlined at the outset. This statement is offered not as a defense of business practice, but rather as an indication of an element of danger. The best results can be secured only by deciding, as soon as possible, on some consistent method or plan for handling real estate.

If the managers of the business are directly interested in real estate, the activities of the business which are concerned with property and buildings will receive more careful attention. There have been cases where a chain-store venture has started out as a real estate operation, the promoter realizing that it would greatly facilitate his operations if he had some legitimate business to put into the locations, some income-producing enterprise to help carry the financial burden of the property.

3. *Development of the real estate department.*—Often the managers of a business, to acquire a desired location, find it feasible to take more space than is actually needed. This extra space is sublet, with the result that the business is led to play the part of a rental and managing agent. To carry on these

functions, a separate real estate department may be formed, or even a separate company, to handle the property.

One of the restaurant chains found itself definitely in the real estate business, in fact, to such an extent that the managers did not have the time to devote to the many problems involved. There was no man in the organization who was capable of handling a real estate department, so the company employed an agent who took care of all of the real estate transactions. Later, as the real estate holdings increased, separate corporations were formed and capable real estate experts put in charge of them.

The real estate department is the ideal type of organization to use while waiting for that stage of development when all property can be turned over to a separate corporation. The real estate department is a flexible form of organization because of its being a department of the business, and, as such, can take over gradually, as it develops, the strictly real estate functions formerly supervised directly by the business executive.

A corporation may be formed to hold the real estate, but it has some possible disadvantages. A corporation may be less susceptible of direct control, may be less under the supervision of the business management, and may not lend itself readily to co-operation with the business itself.

4. *Organization of a real estate department.*—Since many business organizations find it advisable

to place real estate matters in the hands of a real estate department, it becomes necessary to formulate the organization and functions of such a department.

In the first place, the department is usually under a vice-president, or other officer, who is directly responsible to the president. The department may have its own accounting division, but more frequently the general accounting department takes care of all accounts. Likewise, all purchasing of supplies may be taken care of by the general purchasing department of the business.

The staff of the real estate department, in the case of chain stores, is composed mainly of investigators, rent collectors (who are in a sense property managers), and perhaps a construction, alteration, and repair supervisor, and his assistants. Leases and sales are usually negotiated through the vice-president in charge of the department.

Through the formation of a real estate department, the real estate function of the business is centralized and departmentalized. Authority and responsibility are definitely placed. In general, efficiency in handling real estate matters is facilitated by such a departmental arrangement.

5. *Functions of the department.*—The functions of the real estate department are to manage the real estate, negotiate leases and other transactions, collect rents, and make repairs and alterations. The most important function is that of choosing, as oc-

casion arises, new locations for the business, or of providing for expansion. The choice of new locations, particularly in the case of a chain-store organization, involves some well-worked-out system of appraising the properties under consideration. Such work is done by the investigation division of the real estate department. Next follows the task of negotiating either the lease or the purchase of the property. As soon as a location is acquired, the construction and alteration division takes charge of preparing suitable quarters. This work may involve either a new building or the remodeling of one already on the site. When the building has been prepared, the real estate department acts as property manager, taking care of repairs, maintenance, service, and similar responsibilities.

6. *Handling real estate through agents.*—Even though the real estate affairs are handled by agents, the same functions as are performed by a real estate department must be fulfilled.

Pains must be taken to secure an agent known to be reliable and trustworthy. If a professional renting or managing agent is to be employed, only one who is thoroughly equipped to perform the necessary tasks should be considered.

The agent may be put in complete charge of the real estate, under the direct supervision of the president, or he may be charged merely with the duty of negotiating leases, purchases, and sales. He may be the renting agent, but not the managing agent. The

extent to which he has control of real estate affairs will be limited by the extent to which the business can handle its own affairs.

7. *Handling real estate through separate companies.*—Most business corporations that have extensive real estate holdings find it advisable to place title to certain or all of the properties in the name of the separate real estate company. One of the chief advantages of this method is that the real estate is segregated from the business proper, and any loss due to an unprofitable real estate venture does not involve the business itself. Possible damage suits and other liabilities against the real estate company must be settled out of the property of that company, and thus the business itself is not affected. This is particularly true in the case of the foreclosure of a mortgage.

The real estate company, as has been stated, performs the same functions as the real estate department. Because all of the common stock of the real estate company is usually held by the business corporation, the boards of directors of both companies will be the same, and ultimate control of the policies of the real estate company is vested in the business corporation. This condition is as it should be, because the property held by the real estate company is held for the business.

Not only may a corporation be formed to hold all the real estate, but quite often several corporations are formed to hold the several properties. Another

method sometimes followed is to form corporations to hold each separate piece of real estate, and, then, in addition, to organize a corporation called an operating or development company or a land and improvement company. The function of this operating company is to originate the real estate deals, later turning over the property to the separate owning companies.

8. *The real estate corporation.*—If the properties of the business are located largely in one state, it is usually to the advantage of the company to incorporate in the home state, unless the corporation laws are too stringent. In the latter case, Delaware, or some other state whose laws are more liberal, should be chosen. If the property is scattered throughout the United States and Canada, the properties in the United States should be held either by a corporation formed in the state in which most of the property is located, or in a state with liberal corporation laws. The Canadian property may be held by a New York or Delaware corporation operating in Canada as an alien corporation, or may be owned by a company formed according to Canadian law.

It should be noted that, in Canada, the laws of the province in which the real estate is situated must be complied with. Even a Dominion company may not hold land in a province unless it complies with the local laws, and the usual requirement is either a license in mortmain or a license as a foreign or extra provincial corporation. A New York or Delaware

corporation taking title to land in Ontario, for example, should first qualify under the Ontario Extra Provincial Corporation Act. This would enable such a company to acquire and deal with real estate to the same extent as a corporation incorporated under the laws of the province.

9. *Powers of a real estate corporation.*—The powers to be assigned to a real estate corporation should be very broad. They should allow the company to engage in the following activities:

- (a) To buy, sell, lease, hold, or otherwise deal in real property
- (b) To construct, alter, and repair buildings, or other improvements placed on the land
- (c) To buy, sell, or otherwise acquire and hold the stocks, bonds, or other securities of any companies whatsoever, regardless of the type of business engaged in by these companies
- (d) To mortgage its own properties and to buy, sell, hold, or otherwise deal in mortgages and mortgage participations and certificates
- (e) To undertake or direct the management of real property, buildings, and lands
- (f) To buy and hold real estate of every description for investment or otherwise, and to transact the business of a real estate agent or broker
- (g) To survey, subdivide, plot, improve, and develop lands for the purpose of a sale or otherwise, and to do and perform all things needful or lawful for their improvement for agricultural, residence, trade, or business purposes

The control of the real estate company should always be vested in the business, preferably through

complete stock ownership. In some cases, however, the control is placed in a holding company, which also controls the business. Indeed, it is frequently a common occurrence to find the control of the real estate company in the hands of insiders.

10. *The real estate syndicate.*—The real estate syndicate is a temporary association of individuals, or corporations, formed for the purpose of carrying through some particular real estate venture. It may be formed by the officers and directors of the business, by the real estate corporation, or by several corporations or individuals. Frequently, to acquire a location or develop a certain piece of property, a greater financial obligation rests on the business than can be assumed conveniently. In this case, the managers of the business, or of the real estate company, will approach substantial real estate operators, or builders, or even corporations engaged in other lines of business that could use some space in the new location, for the purpose of persuading them to join a syndicate that has been formed to carry out the venture.

The property thus acquired by the syndicate can then be turned over to a corporation, the syndicate members receiving stock for their respective interests. The agreement under which the property is turned over to the corporation may provide that certain members of the original syndicate shall have the right to lease, for a long term, spaces which they acquire

at a stipulated rental. Thus, by the use of the syndicate plan, a location can be acquired for the business without calling upon the company to put up all of the cost.

The real estate syndicate is primarily a method of underwriting an undertaking that is too big for an individual or an individual corporation to handle. It is a very satisfactory and safe method of financing the equity in a piece of property, although the success of a syndicate will depend, to a large extent, upon the promoting ability of the syndicate manager.

Another matter which should receive careful attention, besides the choice of manager, is the distribution of profits. Ordinarily, syndicate members are allowed a six per cent return on their investment, after which the balance is distributed equally between the syndicate members and the syndicate manager. The syndicate managers may even receive a much smaller fee, because part of their income is derived from commissions.

11. *The real estate trust.*—The real estate trust, which exists under the common law as a form of business trust, is not employed to any great extent for holding property, because of certain technical disadvantages. However, it has some advantages over the syndicate, or corporation, and therefore is worthy of mention.

The real estate trust is a form of business organization that operates by placing property in the hands of trustees to be administered for the benefit of the

shareholders or certificate holders, commonly called the beneficiaries. The land trust is an example of this form of organization.

The real estate can be definitely reserved for the use of the business through a trust agreement and through a self-perpetuating body of trustees who manage the property. The form of organization is simpler. It is free from government control. These factors are the chief advantages of controlling the real estate through a trust.

The chief disadvantages of the trust are that its life is uncertain, due to a statutory limitation, and that great care must be exercised in drawing up the trust agreement, because it governs, for the whole life of the trust, the use of the property and the duties and powers of the trustees.

12. *The real estate holding company.*—If the real estate holdings of the business are extensive, it is usually wise to incorporate the separate properties. If this plan is followed, the question arises as to whether the direction of these separate owning corporations shall be vested in a holding company controlled by the business, or whether control shall be held by the business corporation itself. If the properties are to be segregated from the business, the holding company offers the ideal method of accomplishing this end. If the properties are not to be segregated, then the policy of placing them in control of separate owning corporations should be followed.

By using a holding company arrangement to control the real estate of a business, the actual cash investment can be greatly reduced. For example, suppose a business corporation wishes to control ten properties valued at an average of \$500,000 each. The first step is to incorporate the separate properties. Together, the ten corporations would have property worth \$5,000,000. If mortgages could be obtained on the properties up to 50 per cent of their value, the equity would be reduced to one-half of \$5,000,000 or \$2,500,000. By forming a holding company to hold 51 per cent of the stock of the separate corporations, the investment would be reduced to \$1,275,000. If the control of this holding company were turned over to the business corporation through a 51 per cent stock control, the investment would be further reduced to \$650,250. Thus, \$5,000,000 worth of property could be controlled by an investment of only \$650,250. In most cases, however, only one holding company would be employed because of the difficulty of selling stock in a series of such companies.

13. *The real estate operating company.*—The real estate operating company is often a refinement of the holding company, the chief difference being that the operating company is usually an active corporation while the holding company is passive. Although it is not the function of the business to speculate or operate in real estate, many companies, especially chain-store groups, are literally forced to do so in

order to acquire desired locations. For example, one of the cigar chains saw a certain location that it wanted for a store, but at the time it was occupied by a competitor. The competitor's lease was about to expire, and, to get the location, the cigar chain had to outbid the rival store. It became the landlord by leasing the whole building, and then raised the rent beyond the figure that the competitor was willing to pay. The competing store therefore moved. The rents to other tenants throughout the building were likewise raised, and the cigar chain store was able to get its rent almost free. In some cases, chain stores have even been able to get their rent free and, in addition, make a profit on the lease.

REVIEW

Describe the organization of the real estate department and list its chief functions.

How may the broker be employed to assist in managing real estate?

State the advantages of placing the real estate of a business in a separate corporation.

When is it advisable to employ a real estate syndicate? When a real estate trust?

Explain how a real estate holding company may be used to advantage in reducing the investment of a business in real property.

CHAPTER III

REAL ESTATE VALUES

1. *The problem of value.*—Since the business man is charged with the responsibility of providing a suitable location for his business, it is necessary for him to know the factors that affect real estate values. He must know, not only what constitutes a suitable location, but what any particular location is worth to his own business.

From the business standpoint, the best location is one which will produce the largest net income from the particular business over the longest period of time. The value of property is dependent, therefore, largely upon the use to which it can be put, both present and future. The measure of what a business man will pay for a location is its productivity in net income. The price that other bidders will pay is measured in the same way, and the difference, if any, is the result of the location's greater suitability for one type of business than for another. Again, the value of one property, relative to similar locations, is measured by the net returns which can be expected from each, respectively.

2. *Why the business man should know values.*—As can be readily perceived, much depends upon the

ability of the business man to judge the value of real estate. This judgment should be fortified by facts as definite as those employed by expert appraisers, who rely upon their experience of the effect of certain factors on value. These effects should be equally familiar to the business executive. Not only does the business man want to know whether the desired location is worth what is being asked for it, either in the form of rent or of purchase price; he also wants to know what the future trend of values is going to be. In addition, he is confronted with many lesser problems which call upon his ability to judge values, in relation, for example, to financing, to taxation and accounting, to rents, to estimating the cost of an improvement, to the purchase or sale of property, to measuring fire loss, to allocating rental value to various parts of a property, and also to planning a reorganization, consolidation, or merger.

3. *Definitions of value.*—Value has been defined in as many different ways as there are viewpoints or philosophies of value. The more theoretical define value as the measure of desirability. The more practical define it as the price which a thing will bring. These two definitions can be supplemented by a fairly extensive list of others.

Accordingly, value is:

- (a) The price which a buyer, willing but not forced to buy, would give to a seller, willing but not forced to sell

- (b) The sum of the costs, less depreciation
- (c) An individual and personal measure of desirability
- (d) The sum representing so many years' purchase of income
- (e) The net income capitalized at a fair rate
- (f) The present worth of expected future incomes
- (g) The opinion of some qualified person or persons as to the worth of anything, expressed in dollars

Each of these definitions makes a definite contribution to the truth. Each one of them brings out some phase, psychological or material, of the value problem, but not a single item is complete in itself.

4. *Kinds of value.*—Growing out of these various definitions, certain modifying terms are often used to designate particular types of value, as, for example, “market value,” “appraised value,” “assessed value,” and “going value.” Such terms refer to the method or process of arriving at value, and indicate the importance that has been placed on certain factors in valuation.

“Market value” means the price that the property will bring in a free, competitive market. The term “fair market value” indicates the price that a purchaser, willing but not forced to buy, would be willing to pay to a seller, willing but not forced to sell. “Appraised value” may be defined as the value placed upon property by an appraiser. The appraised value should be accompanied by some evidence of the competence of the appraiser to value property.

The "assessed value" is the value of property for tax purposes. This value is placed on the property by the assessors or political officials charged with the duty of appraising property for tax purposes. "Going value" has various meanings, but to the economist it means the present worth of future expected incomes.

5. *Value depends upon use.*—Nearly every piece of land, except the barren wastes, is a suitable location for something. The hillside is utilized for grazing or grapes, the plains for general farming, the valleys and river mouths for trade and commerce. Within the city, Main Street is appropriated for business, and higher, outlying sites for residences. On Main Street, each particular business attempts to acquire the site that is most valuable for its own use.

The value of real estate is a particular problem to the extent that a given site cannot be exactly duplicated elsewhere, and that any one site is suitable only for a few businesses. There is only one Wall Street, and only one site on Broad and Wall Streets that is considered the best location for investment banking purposes. This most valuable corner is the center of the financial district, and the home of one of the oldest and most famous banking houses. In Chicago, there is only one Clark and LaSalle location; in New York, only one Times Square.

Since the use to which property can be put determines the income obtainable and, therefore, its

value, the next step is to study the factors affecting the use of real estate and its income, so that value can be accurately judged.

6. *Characteristics of real estate.*—One of the first characteristics of real estate is its immobility. It cannot be moved from place to place as can other commodities. This is partly offset, from an economic standpoint, by the fact that real estate can be adequately improved. Transportation is another factor tending to offset the condition of immobility. This factor has taken on new importance through the construction of good roads and through a general improvement in all methods of transportation, resulting in rapid transit.

A second characteristic of real estate, and in particular of urban property, is its lack of uniformity. This gives rise to great difficulty both in standardizing land and in standardizing the procedures of valuation or appraisal.

The characteristic of permanency or indestructibility is one that cannot be ignored in valuing real estate. Land used for real estate purposes does not depreciate, but rather tends to appreciate with the increase in population and with more intensive utilization. Land may occasionally waste away by erosion, or lose value, for agricultural purposes, from the depletion of fertility, but, in general, it does not lose value from wear and tear, as do other commodities.

Real estate is not a commodity that can be pro-

duced. Real estate values, however, can be produced by making the land more useful through improvements. Improved means of transportation indirectly give the land an increased place utility.

7. *Factors affecting value.*—Since the cycle of value runs from use through income to value, the factors which affect value are really those factors that affect the use to which property can be put and, therefore, those factors that affect its productive income.

Factors primarily affecting the use of property are location and physical character. Factors primarily affecting the income from property are the type of improvement and market conditions. There are also psychological factors that may affect both use and income.

With this general classification in mind, the next step is to analyze the real effect of each particular factor. It is often said that a chain is no stronger than its weakest link. This is true of value. Some one thing affecting the use or income may greatly jeopardize the value of a piece of real estate. Many times, a restriction as to utilization will materially lessen the value of the property.

8. *The factor of location.*—The traveler in the Mojave or Sahara desert is impressed with the fact that land which is merely land, lacking water, vegetation, and proximity to a center of population, is useless except to be traversed quickly. Contrast the lava fields of Utah with the fertile groves of southern

California. Contrast Bliss, Idaho—a water tank, depot, drug store, post office, garage, and schoolhouse—with the Lake Shore Drive and downtown Chicago, or with Park Avenue, Broadway, or Fifth Avenue, New York. What makes the difference? The answer is—location!

A famous hotel operator once made the statement that there are three things contributing to the success of a hotel, and all three are location. This statement probably underestimates the importance of management, service, and the appointments of the hotel. It does, however, indicate the importance which many business men place on location.

Location has often been called the most vital factor in business success. Good location means accessibility and nearness to centers of population in the case of commercial enterprises, and nearness to raw materials, labor, and markets in the case of industrial enterprises.

9. *Effect of location is cumulative.*—The advantage of location is cumulative. A residential section springs up, and is immediately followed by a group of stores and shops to serve the growing residential population. The residential section is gradually forced farther out by the business section, as the latter grows and expands. Soon a system of transportation must be furnished to bring the shoppers and workers to the business section. This pushing out process often results in a once important business section being deserted for a more desirable one, and

a once valuable residential section being taken over by business. This ebb and flow is continuous, except as city planning and zoning keep the movement within regulated bounds.

Many times, a business will be able to build up goodwill both for itself as a business and for the location. This gives prestige to the section, attracts other stores, and helps to increase the value of surrounding property.

10. *Sectional grouping of business.*—Finding the best location for the business means fitting it into its proper place in the city or town. A city grows only as it serves. Trades naturally group together for the convenience of customers and the commercial or industrial group. Customers shopping for wearing apparel do not wish to travel back and forth from one part of the city to another. Likewise, buyers from out of town prefer to find their lines all in one section. Such shopping centers are frequently located near railroad or steamship terminals or, in the case of retail buyers, near subways, or street-car and bus stops.

The location of the business will be affected by the regional distribution of industries and trades, either as a normal development, or as the result of city planning and zoning. City regulations may fix the use to which property can be put. Manufacturing industries, because of inadequate labor supply or because raw materials are not conveniently available, may move out bodily, even to distant sections of the

country, as the textile industries of New England have done.

11. *Centers of population.*—Centers of population determine to a large extent the use to which property can be put. Centers of population really create value in a location by making it possible for a merchant to do a volume of business at such a profit as will give a satisfactory return on the value of the location.

Large centers of population, through developing large-scale business, make possible higher rentals. In a metropolis, like Chicago, a soft-drink and sandwich stand, a mere hole in the wall, will frequently do as much business in a day as the general store in Squire-dunk will do in a week. This condition is due to a greater concentration of customers, resulting in a bigger volume of business. Larger profits create a demand for space that encroaches upon the supply, resulting in higher rentals and real estate values.

12. *Transportation.*—Location and transportation are very closely related. In large centers, a great deal depends upon rapid transit. The big shopping centers are large because trolley cars, buses, subways, elevated lines, and automobiles make the places of business accessible to customers. Good roads, with the automobile in general use, mean to the outlying communities what rapid transit means to the city. Property values in the small town, as in the large city, depend upon good transportation.

For a retail business, it is often advisable to locate

close to subway, street-car, or bus stations, or in the railroad terminals. These little islands of business spring up around a terminal to serve the customers regularly getting off at that particular station. Thus local transit systems, by creating desirable locations around their stations, help to make higher values for real estate.

The question of transportation cannot be dismissed without reference to the important elements of time, cost, and convenience. These terms are almost self-explanatory. Naturally, the shorter the traveling time, the lower the cost, and the more convenient the means of transportation, the more beneficial the effect on land values.

13. *Effect of pedestrian traffic on value.*—For some types of business, the accessibility of the location to pedestrian traffic is the chief factor to consider in evaluating a location. If the business is one that depends upon the transient, passer-by type of pedestrian, then the greater the number of passers-by, the more valuable the location, providing these pedestrians are the type of buyer to which the particular store considering the location is catering.

Another factor in judging pedestrian traffic is one which is more elusive and deep-rooted. Is the pedestrian in a buying mood? It sometimes happens that a shop located close to a terminal will not equal the volume of business of one located a few blocks away. This is true because the customer is either rushing to, or hurrying away from, the station, and will not stop

to buy a piece of wearing apparel or a pack of cigarettes in its immediate vicinity.

The rentals at these centers of pedestrian traffic are very high, since the shops or stores that depend upon the passer-by for a livelihood are able to get the volume of sales and profit that makes possible high rents and high values.

14. *Geographical factors*.—Its general contour tends to limit the use to which land can be put. Shape, extent, and nearness to rivers or other bodies of water are important factors affecting value. An island like Manhattan, because of its harbor facilities and nearness to Canada and Europe, has a geographical advantage which makes its value unique. In fact, the island is so valuable, that several times schemes have been promoted to fill in the lower bay and the East River, and thus make available more land.

Cities like Chicago, situated on the Great Lakes, Omaha and Portland on rivers, and San Francisco and Seattle on harbors, have been located where they are because of geographical advantages and cheap water transportation, with the result that the value of the section as a whole, and of the individual sites located in these cities, has increased rapidly. Good harbors and nearness to populated interiors make for greater business with foreign countries, as well as for coastwise trade and domestic commerce. More business results in a greater demand for space and in higher values.

15. *Topography and soil*.—Topography affects

value very much as contour does, except that topography refers more to vertical shapes and distances, that is, to hills and valleys, while contour refers to horizontal shapes and distances. A visit to San Francisco, to Seattle, or to any town located in the rolling hills of the Middle West or in the rugged mountain section of the Far West, will convince the observer that altitude, ruggedness, and irregularity do have an effect on value.

Streets running up the side of a hill are less desirable for business purposes than those on the level. Land above grade is less valuable, because of the expense of bringing it down to the street level. A town on a mountain top has less chance of expansion than one in the valley. Poor topography results in inaccessibility and lower values.

The character of the soil, especially if extensive improvements are planned, must also be considered. Swampy soil does not furnish a good foundation for a building. Solid rock, although furnishing a good foundation, may add to the expense of preparation and thus reduce the value to the extent of the added cost. On the other hand, if the building is to be a large one, solid rock may prove to be an asset.

16. *Street and block layout.*—In cities, the street and block layout, particularly in the business section, is of vital importance. The width of the streets has much to do with the accessibility of property. Pedestrians in congested areas will avoid crossing wide and busy thoroughfares. Street layouts often result in

wasted space and in isolated sections. Streets that are too narrow hinder traffic and discourage the customer who comes in an automobile.

The shape and size of the block have a part in determining what type of improvement is feasible, the income that can be obtained from that improvement, and the consequent value of the lot. An island or triangle left by the intersection of two busy thoroughfares is often undesirable for business purposes, because it is inaccessible, irregular, and impossible of complete utilization. Loss of light and air are sometimes directly attributable to the shape of the block. Excessively long blocks, especially on cross streets, leave unused space at the center, which has lower value, and the same is true of too large blocks, if they happen to be square.

In this connection, the influence of parks on value may be considered. A property facing on a park is usually more valuable, for some business purposes, because of better light and air. Property around a public square in the center of town in an agricultural section is likely to have the highest value for business purposes. Since towns laid out on this plan usually do not grow very rapidly, business property on the public square will probably remain stable or even increase in value slightly.

17. *Plottage and corner influence.*—Plottage adds to value in that a group of lots joined together into one parcel is usually more susceptible of profitable improvement than is any one of the separate normal

or irregular lots. The fact that several lots have been assembled into a plot adds value in proportion to the extent to which plottage makes the land more useful as a larger unit. The added value may be 10 per cent or it may be as high as 50 per cent, depending entirely on the difficulty of assembling the plot and the economic advantage of the larger unit.

Corner influence is readily appreciated. The corner lot is more valuable than the inside lot because it has more light, air, and display space with which to attract customers. It profits by being on two streets instead of on one. Again, trolley cars and other means of transportation usually stop at corners.

The added value of a corner lot over a normal inside lot will depend upon the relative importance of the intersecting streets. This addition in value is usually about 50 per cent, but circumstances, such as the amount of frontage or the corner angle, may increase or lower this figure. The corner influence of two parallel streets will not be equal unless they are very much alike and are equally important as business streets.

18. *Normal and key lots.*—The normal lot is the standard adopted by any city or section. It may be 25 by 100, 40 by 100, or 50 by 150 feet, or any other convenient area, depending upon the size and shape of the block. Such a standard lot is the unit of value.

A key lot is so termed because of its strategic position within the plot, usually next to the corner. Without it, the plot is not susceptible of complete utiliza-

tion. It may be of the normal size, it may be odd-shaped, or it may be merely a gore, or small strip. If large enough, the key lot may have value in and of itself because of the use to which it can be put.

A group of lots has added value, because the lots are contiguous. A gore or small strip may have come into being as the result of an error in survey, thus breaking up the contiguity. As a general rule, the value of such a piece comes exclusively from its being a key in the completion of a plot. This value is measured by what it costs to get possession, plus the loss in value that would accrue to the whole plot were there delay in getting possession. In other words, the gore has a "hold out" value.

19. *Improvements.*—One of the first considerations in improving a plot with an adequate building is the choice of a type that will fit into the district. For what kind of retail or office building is the location suitable? What is the district trend in building?

In some instances, a business corporation is strong enough to establish a new district trend, eventually remaking the neighborhood. Some time ago, a bank in a western town was forced to foreclose a mortgage on a six-story office building located on a quiet street. The bank moved its quarters into the ground floor of the building and then persuaded the leading merchant of the town to build a four-story department store on the opposite corner. What had been a neglected area was converted into a new and prosperous business center.

In some sections, a one- or two-story building is an adequate improvement, while in other areas a fifty- or sixty-story skyscraper is required. For a department store, not height but floor area is important. For a specialty shop, exclusiveness and appointments are important.

Large investments in buildings or other improvements in the neighborhood exert an influence almost as powerful as zoning or natural topography in setting values. Millions of dollars invested in skyscrapers and in expensive plants cannot be hastily scrapped. The locating of large buildings or manufacturing plants in a section encourages the building of similar structures.

Nevertheless, even in more or less crystallized areas, there is always a danger that the business or industrial center will shift. In the future, as in the past, such shifts will probably take place in well-defined cycles but at a slower rate. The movement of the textile mills from New England to the South is an example of a shift which affects not only individual cities but an entire section. Such movements leave behind them buildings that are no longer adequate improvements, because the use of the district has been changed.

20. *Market factors*.—Certain factors that affect values are strictly tied up with the supply and demand for the products and services of business, for money, and for land. These can be called the market factors.

First and foremost are those changes of supply and demand for business products and services finding expression in the ebb and flow of the business cycle. If business is generally good, the organization finds it necessary to expand into larger quarters or into a new location. Other businesses adopt the same policy, competition for space results, and the price of real estate rises. If the supply of suitable space is limited, the scramble for space results in still higher prices, and there is the added factor of the higher cost of building materials and labor. Larger business profits and greater returns from the proper use of space result in an increased demand for land and create higher values.

The condition of the money market also plays a part in the setting of real estate values. A scarcity of mortgage money and high money rates have a quieting effect on business expansion, and this in turn tends to depress real estate values. On the other hand, even when money is plentiful, the opportunities for profitable investment may be greater in fields other than real estate, with the result that money flows away from real estate and can be obtained only at a premium.

21. *Supply and demand in real estate.*—The supply of real estate is relative to the demand. Supply and demand are two variables which may increase together, may move in opposite directions, may remain stable, or may move in one direction at different rates of speed. The supply of land is itself limited

by the physical area and, in the final analysis, by what is called standing room. Standing room sets a limit beyond which even the most intensive utilization of land cannot be forced.

From the business man's point of view, the supply of real estate means a supply of space suitable for his particular business, and the demand for real estate resolves itself into a demand for particular classes of space in particular areas. For example, the demand for loft space may be outstripping the supply in one section, while, in another, there is an abundance of such space. For some time following the World War, there was a general dearth of office space in many of the large cities. With the return to normalcy, an era of rapid construction began, with the result that there is now, in many instances, an overproduction, notably in the Grand Central and Wall Street zones of New York, the Loop district in Chicago, and the downtown sections of many other cities. Such movements run in cycles and are, of course, temporary, depending largely upon business expansion.

22. *Psychological factors*.—There are some factors affecting value that are not a part of the theory of profits. They may be called psychological factors. Frequently, a business man will choose a location, not because it is the one which will produce the highest net returns, but because it is in the élite business section. This may be attributed to pride or to a craving for prestige, but, nevertheless, it is a factor that

affects what property owners can get for space and what a business man is willing to pay.

Similar to this is the policy of maintaining certain locations at a loss or at least at no profit, merely for the advertising advantage. Many manufacturing concerns doing a national business have opened stores in large cities that are little more than showrooms or display rooms, maintained for advertising purposes. Not enough business is done in the particular location to pay even the rent. Many chain-store organizations have also maintained branches in prominent sections, not because they are profitable, but because the store is a good advertisement for the chain.

REVIEW

List the business situations calling for some knowledge of real estate values on the part of the executive.

Which definition of value, among those given, seems most adequate? State reasons for your choice.

Classify the various factors affecting real estate values. Rank the factors in order of importance.

Explain the effects on value of plottage and corner influence. Define key lot, gore, standard lot.

Compare the relative influence of physical and market factors in determining value.

CHAPTER IV

METHODS OF VALUATION

1. *Methods of arriving at value.*—There are certain well-recognized methods of valuing real estate, several of which follow a mathematical procedure giving them a greater degree of scientific exactness. Much care will need to be exercised, whether one is applying a mathematical method or a rule of thumb, since there are many variable factors in the determination of value and a great deal depends upon the appraiser's judgment of what the future trends will be.

Among the outstanding methods of measuring value are: net income capitalized at a fair rate; the present worth of future net income; various kinds of cost; comparative market prices; and the application of accepted units of value.

2. *Income as the basis of value.*—A thing is worth what it can produce, and this is true of land. Income, known or estimated, is the best and most acceptable basis of value for properties improved to their highest and best use. Since good location means so much to a retailer, any return above cost of goods sold, fair compensation for managerial ability, overhead, and a fair return on the investment, should

be attributed to the location and should be the basis of the value of that location.

Income can best be used as a measure of value, when the highest possible return is being obtained from a location. If the property does not produce a satisfactory return compared with like properties in the district, there is a strong presumption of underimprovement. From the lessee's standpoint, the indication is that the rent has been set at too high a figure.

If value is to be measured by income, pains must be taken to ascertain whether the income is an accurate figure, whether all expenses and contingencies have been taken care of, and whether the income figure is for a good, a poor, or an average year. Equally, if not more, important than the past and present income is the future income. What property has produced in income in the past is water over the dam; what it will produce in the future is the true measure of value.

3. *How to determine the rate of capitalization.*—The general proposition that the value of a property improved to its highest and best use may be determined by capitalizing the net income at the proper rate gives way to the practical matter of determining the rate to apply, when an actual problem is confronted. A difference of but one per cent will make a difference of many thousand dollars in the estimated value. For instance, if a property shows a net income of \$10,000, and this is capitalized at four

per cent, the indicated value is \$250,000. If a rate of five per cent is used, the indicated value is \$200,000. Thus, a difference of only one per cent in the rate produces a difference of \$50,000 in the estimated value.

To arrive at the capitalization rate to use in any given case, there is required a knowledge of the incomes yielded by like properties in the vicinity, a knowledge of unit values for land, and a knowledge of the amounts represented in building investments.

4. *A fair rate of return.*—It has been suggested that the rate of capitalization is important in its application to the value problem. The rate will vary with prevailing rates for money and with the risk involved in the particular location. At any particular time, each class of property should show a certain rate of return, which may be called a fair rate for that property.

The more stable the return from the property, the lower the rate. On a high-class department store site, five or six per cent may be considered as a fair net rate of return; on specialty shop locations, eight to ten per cent; on factories or warehouses, ten to fifteen per cent, since they are special-purpose property; on high-class office buildings four to six per cent; on medium-class office buildings, six to eight per cent. These rates refer to the average rate over a period of years and not merely to rates in a good or normal year. They are also rates which must take

into consideration adequate provision for repairs, maintenance, and taxes, and a reasonable allowance for depreciation and obsolescence.

5. *Income capitalized at a fair rate.*—Having emphasized the importance of accurate income figures and the choice of a fair rate of return, the next step is to apply the method to a problem in valuation.

Suppose, for example, that the normal income from a department store site, before paying interest on the mortgage, but after adequate provision for depreciation of the building, is \$10,000, and that five per cent is a fair rate of return on that type of property. Since \$10,000 equals five per cent of the value of land and building, the value of the property is \$200,000. If the value of the building on the basis of reproduction cost, less depreciation, is \$80,000, then the value of the land is \$120,000. This might indicate that the building is not an adequate improvement for the site, since the land is more valuable than the building.

Determining the present worth of future income as a basis of value is merely an application of compound interest to the problem, instead of simple interest. The value of one dollar due one year from now at five per cent is ninety-five and a fraction cents. The value of the right to receive \$10,000 a year for the expected life of the building, say ten years, is not ten times \$10,000, or \$100,000, but exactly \$79,504.58. Values can be computed for any rate of interest from any book of interest tables. If the rate

of return is expected to increase or decrease, the value of the property will still equal the present worth of whatever the future incomes are expected to be—a figure which will be more or less than the value on a straight-rate basis.

A method used extensively in England is to pay so many years' purchase of income for property, which is another way of estimating the present worth of future incomes.

6. *Cost as a measure of value.*—The accountant has been prone to emphasize cost, less depreciation, as a measure of value. When the question arises as to exactly what must be included under the head of cost, we find a difference of opinion. Actually, there are several kinds of cost—investment, production, reproduction, and replacement costs.

The investment cost is the cost of the land, plus the cost of the building, plus the financing cost, together with carrying charges during construction. In other words, the investment cost is the actual cash outlay that the builder must make.

The cost of production is the original cost, which, of course, does not consider subsequent changes in wages and price of materials. The cost of reproduction is the present-day cost of reproducing the property as it is, brick for brick. This method of cost accounting has an advantage over the production method in that it allows for changes in costs of labor and material.

Those who advocate using the replacement cost go

one step farther and make allowance for the fact that a building is hardly ever reproduced as it was, but is replaced by one of more modern design and construction.

Whichever method is followed, and probably for new buildings the investment-cost method is best, the figure should allow for depreciation. It can be said that income is generally a better basis of value than cost, because income looks to the future, while cost merely rakes over the past.

7. *Investment cost analyzed.*—Investment cost has been upheld by some authorities as the safest method of valuing a new construction project, partly because of the difficulty of applying the method of net earnings capitalized at a fair rate, but mainly because the investment cost is indicative of the owner's investment and, in the long run, tends to equal the value of the property.

W. C. Clark, economist to S. W. Straus & Co., has included the following items in the sound investment cost:

- (a) Land
- (b) Building
 - (1) Direct labor and materials
 - (2) General contractor's fee
 - (3) Architect's fee
 - (4) Engineering fees
 - (5) Incidentals
- (c) Carrying charges during construction
 - (1) Interest during construction
 - (2) Taxes during construction
 - (3) Insurance during construction

- (d) Cost of financing
 - (1) Functions of the underwriter
 - (2) Reasonable charges
- (e) Owner's organization expenses and profit
 - (1) Legal expenses
 - (2) Title expenses
 - (3) Administration, including investigations, appraisals, surveys, researches, etc.
 - (4) Incorporation expenses
 - (5) Normal profit

Items of cost that should be excluded:

- (a) Cost of special hazards
- (b) Bond discount
- (c) Initial operating losses

8. *Depreciation, appreciation and obsolescence.*—

Depreciation and obsolescence apply particularly to buildings, while appreciation applies to both land and buildings. The term "depreciation" means the loss in value due to wear and tear, which may be brought on by the elements or by man or by both. It is the normal wearing away and decay to which all physical property is subject.

The term "obsolescence" refers to loss in value not due to wear and tear, but to diminished usefulness as the result of more modern construction and arrangement of buildings or changing character of neighborhood. Although land does not depreciate or lose physical value, its location value may decline.

Appreciation, on the other hand, refers to the increase in use values of land. It is brought about by a higher type of utilization, an increase in population,

the development of the area, or by money-price fluctuations. Buildings may appreciate on account of higher labor and material costs for building, but normally the loss in physical value due to depreciation offsets any increase.

9. *Computing depreciation and obsolescence.*—The rate of depreciation varies according to the type of building and the care that is taken to keep it in repair. For buildings in an ordinary state of repair, the table prepared by Zangerle is frequently used in computing structural depreciation. According to his figures, the cumulative per cent depreciation of present-day cost in the case of fireproof stores and office buildings aged one, five, ten, and fifteen years is, respectively, $1\frac{1}{2}$, $7\frac{1}{2}$, 13, and 18 per cent. For fireproof industrial buildings, the per cents at the same ages are $1\frac{1}{2}$, $7\frac{1}{2}$, 15, and 20.

Obsolescence is much more difficult to compute and the calculations are more open to question. The Evers tables of structural and commercial depreciation, although published in 1910, are still used by some appraisers for computing this factor in valuation. Owners of property are prone to disagree with estimates of obsolescence, and many appraisers omit its computation entirely in valuing residential and office buildings.

As the result of a request from the United States Bureau of Internal Revenue for a schedule to be used in determining depreciation and obsolescence allowances in income tax returns, the National Association

of Real Estate Boards appointed a committee, in 1927, to determine the economic life of various types of real estate improvements. The findings of this committee were presented in 1928 in the form of a table, which we give with the permission of the National Association:

THE ECONOMIC LIFE OF VARIOUS TYPES OF
CONSTRUCTION

TYPE OF BUILDING	TYPE OF CONSTRUCTION					
	Steel frame fire- proof	Rein- forced con- crete	Masonry slow- burning with or without steel frame	Masonry with frame interior	Frame	Any other
Office buildings.....	40	40	35	30	25	20 years for pier and special com- modity ware- houses, frame and covered frame skeleton
Stores.....	50	50	40	35	28	
Warehouses.....	55	55	48	42	35	
Loft buildings.....	45	45	35	30	25	
Factories.....	40	40	35	30	25	
Garages, public.....	50	50	35	30	25	
Theaters.....	33½	33½	25	22	20	
Hotels and elevator apartments.....	35	35	28	26	22	
Apartments and flats without elevators...	40	40	35	30	25	
Stores with 1 or 2 stories or rooms or apartments.....	40	40	35	30	25	
Dwellings, 2, 3, 4, family.....	42	42	38	33½	30	
Row houses.....	45	45	40	35	30	
Dwellings, one-family Any other.....	50	50	50	50	33½	

10. *Appraised value*.—The term “appraised value” is often used, but it is meaningless unless qualified, or unless the purpose of the appraisal is known. Even the term “fair appraised value” may

mean several things. If found for the purpose of a loan, it may be high; if obtained for tax purposes, it will probably be much lower. One public utility gave the fair appraised value of its property, for tax purposes, as \$1,900,000, and the same value, for rate-making purposes, as \$3,200,000. This is a large spread but not unusual.

The appraised value should be arrived at only after carefully considering all of the factors affecting value, including the effect of future trends, particularly of rents and of income and expense schedules. From the standpoint of the business man, the operator, or the investor, the value of property depends more on the future than on the past or present. An increase in population, better means of transportation, a shift in area utilization, a general increase in rents, a decline in operating expenses, taxes, and lower interest rates may all affect future values.

The trend in the uses to which property is put can often be judged by observing closely the kind of tenants located in the district. Are they of the best sort? Are they planning to remain indefinitely, or temporarily? Another good indicator is the improvements in the district. What are their extent and character? Will such facilities be further developed? These and similar factors require careful study.

REVIEW

Name the outstanding methods of measuring real estate values. Discuss the use of income as the basis of value.

Explain how to determine the rate of capitalization for val-

uing property on the basis of income. Indicate how the rate will vary with different classes of property.

Name the different kinds of cost employed in valuation, and the more important items to be considered in determining the investment cost.

Explain: appreciation, depreciation, obsolescence, appraised value.

CHAPTER V

METHODS OF VALUATION (*Continued*)

1. *Comparative market analysis.*—While it is true that capitalization of the net income is the preferred method of valuing properties which are improved to the highest and best use, there are numerous instances in which the method is either inapplicable, as in the case of unimproved land, or where the results might be actually misleading. When income analysis cannot be used, comparative price analysis must be employed. Even in the case of properties where valuation by income analysis is possible and desirable, comparative price analysis is useful as a check upon the accuracy of the findings. In some instances, underimprovement or overimprovement may be revealed.

Valuation by price comparison rests upon the established fact that, where use values of land are similar, unit values can be ascertained that will be uniform over a given area. A street in a residential section is bordered by lots all having a like utility—improvement with homes. Land fronting on a main business street has a utility for retail stores, office buildings, banks, and similar business structures that will be occupied by those enterprises and pro-

fessional men who can afford to pay a premium for location.

In the case of the purchase of a dwelling in an established residential section, the only data bearing on income are the rents commanded by houses in the vicinity. If a sufficient number of properties are rented, an inferential income for the property in question may be established, and a value reached by capitalization of the inferred income. Both as a check, and as the preferred method of valuation in case data on rentals are insufficient, the value of a particular property may be reached by separate valuation of land and building—the former by comparison, and the latter by reproduction cost, less depreciation.

An investigation of sales actually made in the neighborhood will give the basic data. These sales prices may be integrated by estimating the building values, leaving the residue as the amount paid for the land. If a sufficient number of cases are taken, a fair unit value for land will appear, say, \$100 per front foot. The house is then valued by reproduction cost, less depreciation, and the land and building, taken together, show the value of the parcel as it stands.

2. *Cautions in making a comparative analysis.*—In using comparative sales prices as a basis for valuation, discretion, common sense, and acquaintance with the trend of prices and the movements of population in the city are necessary. If a very active market has

been in progress, with rising prices, it cannot be assumed that the prices of today are reasonable. They may be inflated. If it is known that a "boom" has been in progress, a long-term trend of unit prices may be established. This will show the rate of price appreciation that has been normal in the past, and the deviation from that rate brought about by the boom. Projection of such a line into the future may reveal the fact that present prices are discounting normal growth by several years. There is, moreover, an evident indication of a price structure which is too high and a definite suggestion to defer purchases.

A variation from normal growth may also be caused by a change or impending change in the use value of land, as when a business district is encroaching upon a second-grade, run-down residential section. In this case, recent sales prices reflect the changed use, and prices of the past should be disregarded.

To consider an example of the use of summation values as a check upon values derived by income analysis, the case may be supposed of a property which has an indicated value of \$75,000 by income analysis, but where the land and building, valued by price comparison and reproduction cost, less depreciation, show a value of \$100,000. Particularly if the structure is new, there is a clear suggestion here that the land has been overimproved. Either the owner has erred in judgment in erecting too costly

a structure upon low-priced land, or else the building is a pioneer and the use values in the district have not developed to the level anticipated.

In the same way, summation may be used as a measure of underimprovement. A property in a street which is rapidly going over to business uses is improved by an ancient residence, now in use as a rooming house. If the property were improved by a building with retail stores on the ground floor and offices above, the income might be \$14,000 and the value of the plot, so improved, \$200,000. Arriving at the value of the land by comparison, and of the present building by reproduction cost, less depreciation, will give a much lower figure, and the difference measures the underimprovement of the plot. In this case, an effort to value by income analysis would be positively misleading, inasmuch as the improvement does not enable the property to show its true earning power.

3. *Units of value.*—To assist in the standardization of value concepts, certain units have been chosen as measuring tools. Among the outstanding units applying to land are front foot, square foot, and standard lot values. Applicable to buildings are cubic foot, square foot, and room values.

The front foot value is that of a strip of land, one foot wide and 100 feet deep, or a strip one foot wide by the depth of a standard lot.

The square foot value is the average square foot value of a plot regardless of its size or shape, al-

though the square foot value of a normal lot should be the basis of comparison. If the lot is narrower or deeper than a standard lot, there will be a corresponding effect on square foot values. If the lot is a corner lot, or if the land has added value due to plottage, the unit value will vary accordingly.

The standard lot varies according to the community. In some cities, it is 25 by 100 feet; in others, 20 by 100, 50 by 150, or 40 by 120 feet. Thus, again, if the lot is quoted on the standard, the exact size of the standard should be ascertained.

Cubic foot, square foot, and room values apply to buildings in the same manner in which the other units apply to land. In finding the cubic foot value of a building, the total value of the building is divided by its total cubical content, which is the product of its length, breadth, and height. Dividing the total value of a building by the number of square feet of rental floor area gives the value per square foot. The room value is merely the total value of the building divided by the number of rooms.

4. *The use of tables.*—Mathematical tables are invaluable to the appraiser in the process of valuing property. Among those in constant use by appraisers are tables of interest, compound interest, future worth, present value, depth coefficients, rents for fractional parts of a month, depreciation and obsolescence, corner reflection coefficients, frontage equivalents, and cubic foot and square foot construction costs for various types of buildings.

In addition, the Hoffman rule, the Davies rule, the Somers system, and many other formulae and rules-of-thumb are used continually. In appraising the value of life estates, mortality and present worth tables are both used. All of these tables can be found in any good manual on real estate appraising, and most of them can be found in books containing insurance or computing tables.

5. *Methods of computing urban land values.*—Of the mathematical methods in use for determining the value of a city lot or of any of its parts, the oldest is the Hoffman rule, devised in New York in 1886. According to this rule, two-thirds of the value of a standard lot, 100 feet deep, accrues to the fifty feet nearest the street frontage. The whole lot is divided into strips five feet wide across the lot, and a percentage of the lot's total value is assigned to each strip, the percentage increasing with the strip's proximity to the street.

An extension of the Hoffman rule was made by Davies, a New York broker, who assigned a value to each foot in the lot, instead of assuming, with Hoffman, that the feet within the five-foot strips were of equal value. Davies worked out a formula whereby the value of any strip of lot can be ascertained for any foot or inch of width or depth, provided the value of the standard lot is known. For convenience, the Davies computations are published in the form of tables, which can be consulted at realtors' offices.

A rough but convenient rule-of-thumb is the

famous 4-3-2-1 rule, which can be used to get a preliminary estimate of value. By this rule, a lot is divided into four strips. The one fronting on the street is given a value equal to four-tenths of the whole value of the lot. The strip next in order is assigned a value of three-tenths, the third strip a value of two-tenths, and the fourth and most interior strip, a value of one-tenth of the total value.

Unit foot values, following the principles introduced by Davies, Somers, Zangerle, and others, are now coming to be accepted as standard. The unit foot stands for the accessibility or usefulness of one foot of street frontage, having a depth of one hundred or some other convenient number of feet. It is convenient to have a unit of this sort for comparing one property with another, both for real estate transactions, and for the government's purposes of assessment and taxation.

Additional values, as we have seen, must be assigned to lots used for business purposes and located at street intersections, thereby sharing in "corner influence." Formulae and tables are available for computing this increment of value, and also the values of irregular "inside" lots. A roughly approximate rule for computing corner influence may be employed by finding the value of the lot fronting on the higher-priced street, and adding to it, seventy-two per cent of the value of a lot of the same width, fronting on the intersecting street. If the corner lot is a triangle, its value is found by extending it in

rectangular form, and applying certain percentages as worked out in mathematical tables by Zangerle, Somers, and others.

6. *Methods of computing the value of improved properties.*—In valuing improved properties, the usual procedure is to estimate, first, the value of the land and building. Then the value of the improvement or building is subtracted from the total to give the value of the land. A preliminary step, of course, is an investigation to determine whether the building is an adequate improvement, the test being whether it is producing a maximum income and is perfectly suited to the district in which it is located.

Any building that can fairly be considered an adequate improvement on the land is worth its investment cost, if new, or, if old, its cost of reproduction, less depreciation and obsolescence. By consulting and applying standard tables of building costs to the floor area of the building (square feet), or to its cubical content, a fairly accurate estimate of reproduction cost can be made. Buildings rise in cost per unit of cubic feet or per square foot of floor space according to height and materials of construction, fireproofing, type of heating, appointments, and so forth. In ascending order of cost may be listed frame dwellings, brick dwellings, cold water flats (brick), non-fireproof loft buildings, steam-heated, non-fireproof apartments, fireproof loft buildings, fireproof elevator apartments, hotels, and office buildings.

Knowing the present value or reproduction cost of

the building, and the percentage return from similar buildings in the district, the appraiser can determine what figure will represent a fair return on the investment. This amount he will subtract from the net income of the property, obtained after deducting operating and carrying charges, including allowance for depreciation and obsolescence. The remainder from subtracting interest on the building from net income is the income from the land, which he will then capitalize at the current rate for such investments, giving him the present income value of the land. In figuring income, the appraiser must take into consideration the character and efficiency of the management. A typical appraisal work sheet follows:

APPRAISAL WORK SHEET

Date	19....
Owner	
Legal description	

COSTS

Land:

Dimensions, x ft.
Restrictions by law

Other restrictions

Trend of value in area

Assessor's valuation for 19....

\$.....

Fair market value of land

\$.....

Improvements:

General description

Type of construction

When built, 19....

Tenancy and use of building

Number of stories, General condition

Number of basements, General condition

APPRAISAL WORK SHEET (*Continued*)COSTS (*Continued*)

Dimensions:	
Height, ft.	
Width, ft.	
Depth, ft.	
Cubic contents, ft.	
Net rentable area, ft.	
Number of elevators	
Assessor's valuation for 19....	\$.....
Cost of building when erected	\$.....
Cost per cubic foot.....	\$.....
Cost per square foot.....	\$.....
Other improvements.....	\$.....
Carrying charges during construction, cost of financing, etc.....	\$.....
Total cost of all improvements.....	\$.....
Less depreciation and obsolescence.....	\$.....
Total cost of improvements in present condition.....	\$.....
Total cost of land and improvements.....	\$.....

ANNUAL INCOME

Gross annual income:	<i>Actual</i>
Basement—Rentable area, sq. ft.	
at \$ per square foot.....	\$.....
Stores—Rentable area, sq. ft.	
at \$ per square foot.....	\$.....
Upper floors—Rentable area, sq. ft.	
at \$ per square foot.....	\$.....
Other income.....	\$.....
Total gross actual income	
(vacancy allowance.....%).....	\$.....

ANNUAL EXPENSE

	<i>Expenses per sq. ft. rentable area</i>	<i>Total actual expenses</i>
Operation:		
Cleaning.....	\$.....	\$.....
Electric system.....		
Heating.....		
Plumbing.....		
Elevators.....		
Power.....		
Management.....		
Other expenses.....		
Maintenance:		
Alterations.....	\$.....	\$.....
Building repairs.....		
Decorating.....		

APPRAISAL WORK SHEET (*Continued*)ANNUAL EXPENSE (*Continued*)

Fixed charges:		
Property taxes.....	\$.....	
Other taxes.....		
Insurance.....		
Depreciation and obsolescence.....	\$.....	\$
Total Expenses.....	\$.....	\$

ACTUAL NET INCOME

Actual gross income.....	\$.....
Less actual expenses.....	
Net Income.....	\$.....

VALUATION

Cost of property:	
Land.....	\$.....
Improvements.....	
Total.....	\$.....
Gross annual income.....	\$.....
Gross annual expenses.....	\$.....
Net annual income.....	\$.....
A fair rate of return on the investment in this property is.....%	
The value of the property based upon the net income capitalized at a fair rate of return is.....	\$.....
The fair cash value of the property is:	
Land.....	\$.....
Improvements.....	
Total.....	\$.....

7. *Values of vacant and improved land.*—The value of vacant land depends upon the net income which can be produced if the land is adequately improved. The value of improved land depends upon the income which the site will produce. If the present improvement is adequate, the income reflects true value but not otherwise.

Any increase in the value of property accrues to the land, since a building loses rather than gains value. The value of land, in that case, is the total

value of the property, minus the cost of reproduction, less depreciation.

The value of an improvement or building at its completion is normally its investment cost, since the building would not normally have been constructed, unless it had been anticipated that the income would show a fair return upon the investment. The value of a building which has been constructed for some time is normally equal to the cost of reproduction, less depreciation and obsolescence. This statement applies with particular force if the cost of construction has gone up.

8. *The valuation of industrial property.*—Industrial properties have valuation problems setting them apart from ordinary commercial properties. Land for factory purposes usually ranks rather low on any list of land values based on location and use, being outranked by land used for financial houses, high-class retail business, high-class residences, hotels, office buildings, wholesale business houses, apartments, tenements, small residences, and even suburban or detached residences. In construction and appointments, the majority of industrial buildings do not compare with office and retail buildings.

A rise in the value of land used for industrial purposes, such as may be occasioned by the extension of a city's retail district around the factory, may work injury to a manufacturing concern, through raising the item of taxes to so prominent a place in its cost of operation that the concern can no longer compete,

on a cost basis, with others located on cheaper land. Again, industrial properties differ from other classes of real estate in that rentals from them do not furnish a reliable check upon their values, since they are not generally listed among renting investments. The growing use of standardized design in factory construction has, however, widened the marketability of industrial buildings.

The general valuation procedure is to compute the reproduction cost of an industrial building, allowing a reasonable amount for depreciation, and writing off all important items of obsolescence. Such items are particularly numerous in industrial properties, due to changes in machinery, power supply, production policies, building construction, and the like. Tables of depreciation and obsolescence are useful here, as in other valuation tasks, but the appraiser should ordinarily invite the assistance of an experienced construction contractor and go over the plant, item by item. In the end, the value of the land, plus the value of the buildings, will be the value of the property.

9. *The value of leaseholds.*—It is often said that a leasehold is worth what can be gotten for it. In one sense this is true, but frequently the lessor cannot get what the leasehold is worth, when measured by any fair standard.

Not long ago, a twenty-year lease, with two twenty-one-year renewals on a six per cent reappraisal basis, was offered to a chain store for \$100,000.

The net rental, above rent to the landlord, taxes, insurance, light, heat, and janitor, was \$14,000. On the face of it, this would seem to be a fair rate of return—14 per cent on an investment of \$100,000. It should be remembered, however, that the subtenant's equity in the lease, or the \$100,000, would be wiped out in twenty years by the reappraisal renewal clause. Since this is the case, the \$100,000 must be amortized within the twenty-year period. This will require, at compound interest, an annual sinking fund of approximately \$2,500, reducing the net income to 11.5 per cent.

The method we have used is not entirely accurate, because in reality the purchaser of the lease is buying the right to receive \$14,000 a year for twenty years. The present worth of the right to receive \$14,000 a year for twenty years, at eight per cent (considered a fair rate of return on the average type of income producing property), is \$137,452. However, the leasehold value will disappear at the end of the first period, because of the reappraisal clause, and it is necessary to set up a sinking fund to equal, at the end of twenty years, the present worth of \$137,452.

Since sinking funds are normally invested at low rates, we shall use four per cent as the rate, making the present worth of the sinking fund \$62,732. This figure, subtracted from the present worth of future incomes, gives an actual value of the leasehold, at the present time, of \$74,719, instead of the \$100,000 that we assumed in the preceding paragraph. If the rents

should tend to increase, the same method could be applied to the varying annual rentals.

10. *The improvement of valuation methods.*—It is well to know something of the efforts being made by realtors, professional appraisers, and state tax commissions to establish better and more uniform procedures in real estate valuation. At present, the measures of value prescribed by the states are confused and overlapping. A recent survey showed the use of twenty-one different bases for assessment purposes, including the price the property would bring at a private or voluntary sale, the amount at which a property would be taken in payment of a just debt due from a solvent creditor, the cash consideration which can be secured in the ordinary course of business, the price which can be realized in a “willing buyer, willing seller” transaction, and, in some states, the earning power of the property.

Minnesota, North Dakota, Colorado, and West Virginia, through their tax commissions, have taken the lead in furnishing county assessors with more up-to-date appraisal methods, through the publication of detailed manuals and instructions. More recently (1928), the Illinois Tax Commission has adopted the unit foot as the measure of value, besides making mandatory, both in assessments and in appeals therefrom, the use of computation formulae, depreciation factors for buildings, and other valuation tools frequently ignored by assessors.

Mention should be made, also, of the attention be-

ing given to valuation methods by the National Association of Real Estate Boards and by the professional appraisers who have taken the lead in developing and making better known more accurate methods of determining real estate values. The business man interested in obtaining a firmer grasp upon his real estate problems will do well to keep in touch with these efforts to bring order and precision into a field that, at best, is difficult of analysis.

REVIEW

Show how comparative price analysis supplements the method of capitalizing net income, in valuing real estate. What cautions must be observed in price analysis?

Explain the use of unit foot values. How is corner influence computed?

Compare the methods of valuing improved and unimproved properties.

Discuss the valuation of industrial property; of leaseholds.

What is being done to improve valuation methods?

CHAPTER VI

CHOOSING A LOCATION

1. *Importance of location.*—Whether the business is that of manufacturing or retailing, or both, whether the site to be chosen is for a factory, warehouse, offices, showroom or a store, much care must be exercised in any choice that is made, since the desirability of the location will determine to a large extent the volume of business that can be transacted in it.

Providing a suitable location for the business may involve a rather extended and scientific survey of available locations and the construction of a building, or it may involve only the leasing of suitable quarters.

The importance of a good location for the business cannot be overemphasized. Once a choice has been made, it is difficult to effect a change. The average business cannot afford to change its location every month or even every year, not only because of the expense of moving but also because customers as they become acquainted tend to associate a business with a certain location. Then, again, much has usually been invested in a location, if it has been necessary to build. Even if no building has been erected, property may

have been leased for a long period, and it is again inadvisable to move.

The success of a location depends on its accessibility to customers, on whether it fits into the neighborhood, and on whether net profits or sales in that location warrant the price which has been paid for the site.

2. *Location the problem of each particular business.*—Every type of business has its own problem of location in every city or town. No two locations in any particular locality are exactly alike. Very few sites are equally suitable, except for a small group of businesses. In a dry-goods retailing section any particular location might be suitable for a specialty shop, or for a drug, cigar, or candy store, but not for a manufacturer of automobile accessories, or for a job printer.

Choosing a location for different types of retail stores is as variable a problem as choosing a site for the factory or warehouse. One type of retailer depends upon passing pedestrian traffic; another depends upon goodwill and a built-up clientele of customers. One factory must be near the source of raw materials, another near the source of supply of semi-finished products, still another near an adequate supply of labor, water, or cheap power. All vary in the particular factor or factors having the greatest weight in determining the final choice of location.

3. *Analyzing the problem of location.*—The analysis of locations requires the expenditure of much

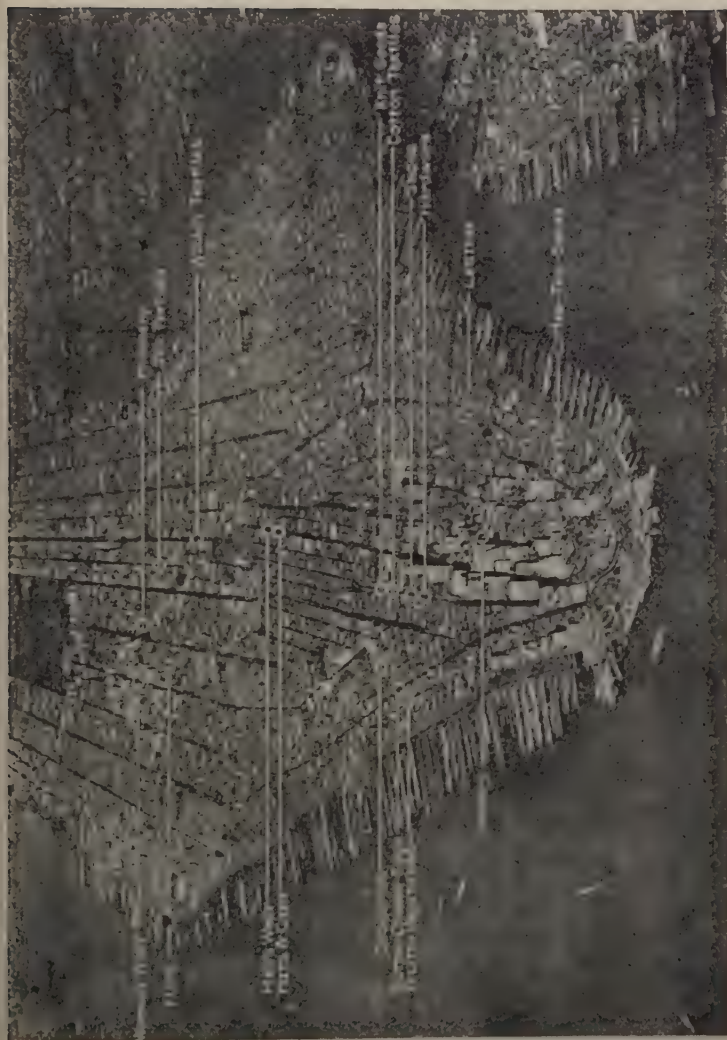
care and forethought. Each step in the procedure must be carefully checked.

If it has been considered advisable to expand in a certain city or locality, then all of the available sites in the locality should be listed. This may be done through brokers or the task may be assigned to the real estate department. Out of the total list at least one or two desirable locations will probably deserve further investigation.

The investigation should cover many factors, including cost, size of plot, location of competitors, transportation, nearness to sources of supplies, pedestrian traffic, character of neighborhood, trend of the area, type of buildings, trend of rents, trend of values, and comparison of the rents or values. It may involve pedestrian counting or checking.

4. *Location of competitors.*—The location of competitors is one of the first things to consider in choosing a location. It is not always an indication that a certain section is good just because a competitor is located there. The competitor is fully as susceptible to error in judgment as anyone else and, even if successful, his success may have been achieved in spite of his location.

Many instances can be cited of enterprises that have built up a large business on what is technically a poor location. This has been done by deliberately employing methods of diverting business from its accustomed thoroughfares, thus offsetting the disadvantages of location. Chief among such methods,



Courtesy of Regional Plan of N. Y.
 Location of principal concentrated wholesale markets in Manhattan. Note that the only ones centering in a high-priced building area are jewelry, silks, millinery, and women's wear.

for retailers, are continuous and adequate advertising and a merchandising policy featuring low prices or quality products. One nationally known chain-store organization deliberately selects locations on side streets a little off the main retail section, to gain the advantage of lower rents, depending upon its reputation to attract customers. Obviously, not every business can afford to follow this example.

As a rule, therefore, the location of successful competitors does indicate that very good judgment has been exercised as to the desirability of a location. Furthermore, business makes business. Many competing retailers will locate side by side on the theory that each may have an advantage over the other in price, in service, or in some other important respect and that customers will shop and finally buy from that store which offers the most desirable advantages.

In some instances there is not room for two concerns in competing lines. It may be that there are not enough customers with sufficient purchasing power to justify two stores in the same business within the same area. If so, a market survey should reveal this situation and thus avoid loss.

As an aid in checking competitive conditions in various lines of retailing, we give on page 83 a table compiled by the U. S. Census Bureau in 1928 (Census of Distribution), showing the average population for each store in various types of business for eleven typical cities, namely, Atlanta, Baltimore, Chicago, Denver, Fargo, Kansas City, Providence,

San Francisco, Seattle, Springfield (Ill.), and Syracuse.

AVERAGE POPULATION PER STORE IN ELEVEN CITIES

KIND OF BUSINESS	INHABITANTS PER STORE
Art and Antique.....	13,371
Automobile.....	6,673
Automobile Accessory.....	3,270
Bakery.....	2,548
Boot and Shoe.....	3,346
Building Material.....	6,960
Cigar and Tobacco.....	2,071
Clothing and Furnishing, Men's Ready-to-Wear.....	2,397
Clothing, Women's.....	4,063
Confectionery, Ice Cream, Soft Drinks.....	1,017
Custom Tailor.....	4,245
Dairy and Poultry Product.....	11,772
Department.....	53,486
Drug.....	1,545
Dry-Goods and Notions.....	2,065
Electrical Appliance and Supply.....	9,057
Florist.....	6,686
Fruit and Vegetable.....	2,510
Fur and Fur Clothing.....	19,118
Furniture and House Furnishing.....	2,388
Gasoline and Oil.....	1,643
General.....	90,569
Grocery, Delicatessen.....	325
Hardware.....	2,748
Hat and Cap, Men's and Boys'.....	26,638
Jewelry.....	4,958
Junk.....	36,131
Meat, Poultry, and Fish.....	1,189
Millinery and Artificial Flowers.....	6,136
Motorcycle and Bicycle.....	57,565
Musical Instrument and Sheet Music.....	12,239
Office Equipment.....	15,473
Optical Goods.....	26,995
Paint, Oil, Varnish and Glass.....	11,772
Photographic Supply and Camera.....	63,483
Plumbing and Heating, Fixture and Supply.....	9,447
Radio.....	18,309
Restaurants.....	813
Sporting Goods.....	44,985
Stationery, Book, Magazine, etc.....	6,402
Toy and Game.....	83,860
Trunks and Leather Goods.....	21,227
Typewriting and Calculating Machines.....	40,193
Variety.....	18,610

In using the Census Bureau's table as a guide for selecting a location in any particular city, the retailer will divide the population total for the city by the number of inhabitants per store for his line of business, as given by the Census, and use the resulting figure to determine whether the community is over- or undersupplied with stores of his line.

5. *The influence of transportation.*—Transportation plays a very important part in business success and governs to a large extent the desirability of location. Without adequate means of transportation, the big city would be impossible. Without transportation, raw materials would not be accessible to industry. Transportation brings the customer to the store and the products of industry to the centers of distribution.

The effect of transportation on retail business is difficult to measure, unless we consider that, by means of transportation, people are brought to the buying centers. The volume of business and the profits are, therefore, increased, and locations become more desirable.

Adequate consideration must be given to the means as well as to the extent of transportation. Are the existing facilities making the location more available to a larger and larger section of the population? Does the transportation system furnish cheap, rapid, and convenient transit? How permanent is the system, and, if it goes out of existence, will a new system serve the same territory, or will one section be

neglected for another? These are practical questions which confront the analyst.

6. *One hundred per cent locations.*—Real estate brokers, and particularly chain-store executives, often make reference to 100 per cent locations. The term, without qualification, is meaningless, except as it indicates the best location. Charles Sandford, of the W. T. Grant Co., has defined such a location as “the location that checks the highest with due regard to the traffic desired.” The main point that is to be emphasized is the kind of traffic that is desired.

Mr. Sandford further lists the following elements to be considered in classifying property according to percentage:

(a) *Type of Location.*—Almost all locations may be divided into two classes: men’s and women’s.

A men’s location should be in the buying section of men’s clothing, hats, shoes, sporting goods, and other lines, patronized by the alleged “head of the house.”

A woman’s location is the buying center in which five-and-ten-cent stores, variety, and department stores are located, and in which all lines of female apparel are sold. Public markets and food stores quite often locate in secondary women’s locations.

Owing to traffic conditions that attract both men and women, the main transfer corners are in demand for drug stores and cigar stores.

A good men’s location is usually found to be on the side of the street opposite to the women’s center, or on the adjoining block. Sometimes it is on a side street or a back street. Most often it is in the location of the larger office buildings and banks, which are the focal points of the male traffic.

Women's locations usually form the "hot" spot in every town. These are the high-priced locations, made so by the fact that it is the womenfolk who do most of the family shopping and spending.

After the required type of location has been found, the next classification is:

(b) *Location Percentage*.—This is determined by the use of a stop watch.

Comparative checks are made of various traffic points in the retail district—all of uniform periods of time. The location that checks the highest, with due regard to the traffic desired, is termed "100 per cent." Other locations of the same type are graded therefrom.

The final consideration is:

(c) *Purchasing Power*.—This is determined in relation to the quality of traffic passing a given point. It sometimes happens that the highest traffic point does not represent the highest purchasing power. Traffic and transit conditions usually govern this point. For instance, the heaviest traffic point in New York City is the west side of Sixth Avenue and Broadway, between 33rd and 34th Streets. But the north side of 34th Street, between Fifth and Sixth Avenues, is the best popular price center in the metropolitan area.

7. *Clocking*.—Clocking is a mathematical method of checking the business value of a location. The process consists of counting the persons who pass a certain location during the business hours of each day of the business week. It involves not only the count, but also an analysis of the types of passers-by. Are they men or women? What is their apparent economic standing? Do they carry packages? Are they making purchases in the vicinity? If so, what is the nature of these purchases? Do the passers-by

seem to be in a buying mood or are they merely window-shoppers?

The purpose of clocking is to estimate the potential sales in a particular location as a basis for determining what rent can be paid or whether a building should be erected. The procedure is to count the number of possible purchasers, and then to multiply the number obtained by the average sale.

There are many uncertainties in clocking. First, the number of passers-by will vary through the year; next, the percentage of passers-by who will make a purchase varies; and, lastly, the amount of each purchase will vary among customers. On the other hand, some organizations with experience in this work are able to predict with surprising accuracy the volume of business that can be done on a given site after making a traffic count.

The United Cigar Stores, for example, have accumulated statistics so trustworthy that they can tell how many men of a given number of passers-by will enter their stores, and, further, of this number, how many will buy and what will be the average purchase by each customer. Their location experts have turned in estimates of the first half-year's business for a new store that came within \$200 of the sales actually made.

8. *When to use clocking.*—Clocking is most useful when several locations of apparently equivalent suitability are being considered. It is evident that the

traffic counts must be taken under conditions as similar as possible at the same hours and in the same weather, to insure getting a true comparison of the locations being analyzed. Better results will be obtained, if several men are employed for the count and if the information is gathered over several days or even weeks. Not only the number of pedestrians should be ascertained, but also their sex, approximate ages, and general types, that is, whether commuters, laborers, amusement seekers, or shoppers. The number carrying packages is usually noted as indicative of a shopping purpose.

Clocking is less important for certain businesses than for others. Department stores, for example, have more need of analyzing the market range on which they can draw through their daily advertising. Even the chain stores making most use of traffic counts supplement them by careful studies of comparative markets. To refer once more to the United Cigar Stores, their founder, George J. Whelan, obtained comparative figures on the per capita consumption of tobacco in our larger cities before deciding on store locations. He found that to get the same volume of sales many more men would be required to pass one of his stores if located in Chicago, where tobacco consumption was only sixty-three cents per capita, than if located in San Francisco, where the per capita consumption was \$4.06.

In general, we may conclude that clocking and traffic analysis are more important for the retailer

handling a "repeat-business" line or one depending upon the "drop-in" type of customer. Businesses catering to the needs of men can use this method of analyzing a location very profitably, since men, as a rule, make their purchases at the place most conveniently situated and do very little of the shopping around characteristic of women.

9. *Illusions in traffic analysis.*—In clocking, it is more important to study the type of passers-by than the number. This cannot be too strongly emphasized. Attractive locations are often offered to the business man, and figures quoted to show that by actual count there is an unusually heavy traffic of passers-by, but further analysis is always advisable. An inspection of the types of pedestrians may reveal that they are mainly young clerks motivated by the sole purpose of reaching their offices, in the morning, or of getting home, in the afternoon. There may be no restaurants in the vicinity to attract customers during the leisure part of the noon-hour, and the majority of the workers may procure their luncheons in the buildings where they work. Ten thousand people may pass a specific location without thereby making it serviceable as a business site. This will frequently happen, if the site is located halfway between the main retail district and a residential area.

Too often the question of location for the retailer is made to depend mainly on considerations of traffic, without regard to the market appeal of the goods or the specialty being merchandised. Market anal-

ysis is indispensable. Successful leaders in business are emphatic on this point, many going as far as to state that the number of passers-by is the least important factor they consider in choosing a new location. The practical consideration would seem to be—Does one's business depend upon the type of buyer who makes quick, easily chosen purchases of necessities or of minor luxuries, such as tobacco, that are restocked as soon as consumed? If so, clocking will be a necessary procedure for determining the best of several available locations, and its indications of sales volume will not be illusory.

10. *Choosing a site for a retail store.*—It has already been suggested that the problem of choosing sites for retail stores will differ with the type of store. The choice of a location for a five-and-ten-cent store will differ from the problem of choosing a site for a retail haberdashery. The five-and-ten-cent store needs more space in which to display merchandise than the haberdashery, and it should be located in a general shopping district. The haberdashery may be located in a general shopping district, on the ground floor of an office building, in a railroad terminal, or in any other place where men shoppers can stop to purchase a tie, handkerchief, pair of socks, shirt, or collar.

The retail grocer must follow very closely in the wake of residential expansion. The department store, on the contrary, should locate in the center of the main retail shopping district if, as is most gen-

erally the case, there are adequate transportation facilities serving the district.

Some retail stores find it advisable to locate near terminals or stations. Others must locate in the most élite retail section of the city. For a long time it was considered inadvisable to locate a five-and-ten-cent store on Fifth Avenue. Today the Fifth Avenue five-and-ten-cent stores are among the best.

Because of the habit which some customers have of shopping around, trades and retail businesses of like nature should be grouped together. More shops in the same section attract more customers, result in greater sales, and thus create greater real estate values. In the small town, the corners are much more desirable than inside-of-the-block locations. Nearness to the post office or central building of the town is usually a more desirable location than those farther out, even though they are on the main street. In some instances, one side of the street will offer active business while the other side will be dead. The popular side of the street may shift even in the course of a block or two.

11. *Suiting the location to the enterprise.*—The retailer must choose a location and build or acquire a building that will be in keeping with the character of the store and the type of customer to whom he caters. A department store that has been conservative in its policies and that has not catered to the exclusive customer may make a mistake by moving into an exclusive shopping district characterized by

much show and ostentation. It is a social outcast. The prices are too high for the old clientele, and the store lacks a following among the better class of customers. If it is to be a success in the new location, there must be created a demand for that type of store and a following must be built up. The choice of a retail location may, therefore, mean finding a neighborhood to fit the merchandising policies or possibly even changing the merchandising policies.

Often the business man, led astray by vanity, chooses a location that is unsuitable. It may be on the main street and in the best shopping district, but it is not the location for his particular business. The best retail location in town is no place for a blacksmith shop. Figuratively speaking, many blacksmiths locate their shops on Michigan Boulevard or Park Avenue.

12. *Choosing an office.*—Similarly, in choosing an office, the business must harmonize with its building. Some sections and buildings are more logical locations for certain types of business offices than are other sections and buildings. Thus, dentists and doctors may locate in professional buildings situated in the center of the business sections, or they may locate in apartment houses or residences close to their patients.

The executive office of the company selling a national product should be located in the same section with other concerns selling the same or similar products. It is also advisable to locate near the

railroad terminals so that customers and representatives of the company may lose as little time as possible in making visits to the main office.

If the company is listed on the New York Stock Exchange, it must maintain a transfer office in Manhattan, which logically should be situated in the financial district. If the business is that of exporting and importing, the office should be located near the water front so as to be accessible to buyers or their representatives, and convenient for the handling of incoming merchandise.

13. *Mistaken ideas of economy in office location.*—Office space in the average city is expensive, but it is more economical for a small company to lease the space needed than to erect its own building on the narrow lots usually available. A narrow building is inefficient in that it compels wasteful traveling up and down many stories and prevents a truly economical organization of office routine.

Besides the suitability of the neighborhood, such factors must be considered in choosing an office location as the amount of available daylight, wiring for artificial lighting, elevator service, possibilities of future expansion, proximity to the clerical labor market, shape of the space as well as its extent, and remoteness of the building from unusual volume of smoke, chemical fumes, or vibration of factory machinery.

It is false economy to choose a dark location, however cheap, since office work involves continuous

eyestrain, and inefficiency resulting from unbearable strain will cost more than the difference in rent between a poorly lighted and a well-lighted office. In considering the shape of the space, it is to be remembered that a single large rectangular area can be better arranged than a combination of smaller rectangles, that long, narrow areas are usually inefficient, and that courts or central wells interfere with good office organization where an entire floor is to be occupied.

14. *Choosing a showroom or salesroom.*—Convenience to the buyer is the first and foremost consideration in choosing a location for a salesroom or showroom. Many importing concerns have their merchandise stored in a warehouse by the water front, but they are displaying the merchandise in an elaborately furnished showroom in the uptown section of the city.

Usually the showroom and salesrooms will be located near the retail shopping section, since the specialty shops and department stores are the chief buyers. If possible, the showroom should also be located near the railroad terminals because many of the customers and representatives come from out of town.

15. *The location of factories.*—First, the general location, or city, must be decided upon. It must be near the market either in actual distances or as the result of good transportation. It must be near an adequate supply of raw material. The transpor-

tation facilities must be adequate and low in cost. The labor supply must be adequate.

The character of the laborers must be studied to ascertain their attitude toward employers, strikes, etc. Power must be available. Legislative factors must be considered; taxation, labor legislation, building restrictions, etc., often play a very important rôle. Social conditions, climatic conditions, building costs, banking facilities, trade concentration, and advertising advantages must also be considered.

Once the choice of a general location has been made, the search begins for a site within the community. The problem narrows down to the cost of land, room for expansion, nearness to switching facilities, accessibility to workers, water supply, fire protection, highways, living accommodations, tax rate, railroad or bus rates, cost of power, and similar factors.

Some one factor of special importance may determine the location for a particular business. Some factories which are by-product manufacturers must locate near the supply of by-products. Some locations are chosen entirely for their advertising advantages. Some manufacturers, because of the fact that the product is perishable, must locate close to the consumer, regardless of the distance from the supply of labor and raw materials.

There is a growing tendency among large manufacturing concerns to seek a water-front location. This has been accentuated by the growth of Ameri-

can foreign trade, the dependence of other concerns upon large importations of raw materials from abroad or from coastal cities, and the quest of public utilities and business in general for cheaper transportation. New ports are being developed rapidly along the seaboard, and older ports are notably improving their facilities on both the Atlantic and Pacific coasts. A water-front location must be considered, of course, in relation to railroad terminal and lighterage facilities, but, other factors being equal, there is here a genuine opportunity for the choice of a very unusual type of factory location.

16. *Illustrative check lists for industrial locations.*
—John G. Callan, Professor of Industrial Management at Harvard University, has prepared a useful list of factors to be considered in choosing an industrial location, as follows:

- (a) Materials: raw or worked
- (b) Transportation: cost and service
- (c) Markets
- (d) Labor: suitability, number, efficiency, background, and attitude
- (e) Climate
- (f) Water supply, waste disposal, topography
- (g) Living conditions; community spirit and standards, attitude toward industry
- (h) Laws
- (i) Taxes
- (j) Local ordinances
- (k) Community opinion
- (l) Local capital and banking facilities

This list may be supplemented by one that rates the factors on a percentage basis. The possibility of change in any one of the factors should also be considered.

George Hannauer, President of the Boston and Maine Railroad, in analyzing the relationship between the railroad and the industrial location, has emphasized the following factors:

- (a) Is there an economic field for the industry?
- (b) Will the industry be welcome to its neighbors, or will it be regarded by them as undesirable, and, consequently, be harassed?
- (c) Has the property drawbacks concerning which the industry should know, such as bad foundations?
- (d) Are the taxes reasonable?
- (e) Is the water supply adequate and suitable, and is the cost of it reasonable?
- (f) Is the same true of power?
- (g) Is suitable labor available?
- (h) Can a layout of buildings and tracks be made that will permit of good railroad service and economical handling of freight?
- (i) Is the rate situation such as to enable the industry to compete with others in other sections of the country?
- (j) Is the railroad, serving a given location, the one that can give the industry the best of service, or will the plant owner find that his railroad must switch the bulk of his cars to some other railroad in the first place?
- (k) In short, has the industry as good a chance to succeed in this location as it would in some other location in the same city; or perhaps in some other city; or in some other section of the country?

REVIEW

What general factors are most important in choosing a location for any type of business?

Define a 100 per cent location.

Describe the clocking process.

Why is pedestrian traffic important?

How would you proceed to choose a site for a retail store?
For an office?

List the factors, in the order of their importance, which you would consider in choosing a factory site.

CHAPTER VII

FINANCING

1. *The problem of financing.*—The extent to which a business should acquire real estate depends upon the policy of the company, its need for space, and its ability to finance the acquisition of the property, either from its own resources or with the aid of outside financing.

The purchase of real estate usually involves a very considerable investment—one which cannot be made outright by the average business. Since the main purpose of the business is not that of investing in real estate, the management usually adopts some policy whereby this investment can be reduced to a minimum. This may be done by leasing instead of buying, thus evading the financing problem, or it may be done by depending on outside sources to furnish the bulk of the purchase money.

2. *Method of financing.*—There are two generally employed methods of financing the purchase of real estate. One is to borrow on a mortgage on the property; the other is to sell an interest in the property or business in the form of stocks. If the business is profitable and if money can be borrowed on favorable terms and at favorable rates, the business man should

trade on the equity by mortgaging the property. If the business is unstable and income fluctuates radically, stock should be sold to acquire the site, thus reducing the fixed charges and obviating the danger of losing the property due to default and foreclosure.

Even though the business can afford to buy the property outright, it is often advisable to borrow part of the funds required, mortgaging the newly acquired property, and leaving the balance of the company's surplus for business expansion. Particularly is this true, if money will earn more in the business than must be paid for a first mortgage loan.

Loans are made upon the fair appraised value of the property that is being acquired. This may be higher than the actual cost of the building. In some cases the loan will almost equal the sum of the costs, because, when acquired and improved, the property is worth more than its original cost. A sand dune on the edge of Lake Michigan is worth very little as such, but when acquired by a large steel company and used to develop an important industrial center, this same property is worth many times the original cost.

3. *The amount that can be borrowed.*—The amount of money that can be borrowed will depend upon many factors, including the policy of the lending institution, the condition of the money market, the condition of the real estate market, the trend of values in the particular section, and the

profitableness of the business and general credit standing of the borrower. It is, in general, a sound principle not to attempt to finance real estate on a "shoestring."

Most loans to a business are secured by a mortgage against the land and building. The actual amount that a lender will give depends upon his opinion of the value of the property and of the ability of the business to repay the loan in the future. Savings banks will lend up to 60 per cent of the value of the property; trustees, to 66 per cent; private lenders and lending institutions, to 70 or 75 per cent.

If the lender is liberal in his appraisal, more can be borrowed than if he is conservative. If there is plenty of money available for first-mortgage loans, the borrower will fare better than if there is a money shortage. If real estate is a drug on the market and prices are depressed, the lender will be more conservative than in a good real estate market. If the lender believes that the particular section or neighborhood is on the decline, he will lend only a fair proportion of what he expects the property to be worth in the future. Often the business ability of the management is the factor considered most important by lenders.

Most lenders will make a loan up to 60 or even 75 per cent of the fair value of income-producing property and up to 40 per cent on unimproved property. This, of course, leaves the balance to be fur-

nished by the borrower, and sets up the problem of financing the difference between the price of the property and the amount of money which can be borrowed.

In addition to a first-mortgage loan, the borrower can often obtain a second mortgage, a purchase-money mortgage, or even a debenture loan, to increase the amount of financing by outside fixed obligations, and to reduce to a minimum the difference between purchase price and loans or the actual money put up by the business itself.

4. *The actual investment in real estate.*—The actual money which the business is called upon to furnish in purchasing property is the figure which concerns the business man. He must provide for that amount either out of surplus, through the investment of a special fund, or by the sale of additional stock.

This step in the financing process has been loosely called financing the equity. Normally, the business man thinks of his equity in property as the difference between its value and the amount of the mortgages, rather than the difference between the investment cost and the amount of the borrowings. If cost and value are exactly the same, the equity does equal the difference between cost and mortgages. If the value is greater than the cost, which is usually the case, the equity is greater than the amount which must be raised over and above mortgages in order to acquire and pay for the property.

From a practical viewpoint, the money that must be raised over and above the amount furnished by lenders is the actual investment in real estate.

5. *Illustrative financial plans.*—Two financial plans are given to illustrate the factors of cost, financing, expense, and income for a ten-story office building. In plan No. 1, 50 per cent of the cost is borrowed on a first mortgage. In plan No. 2, 66 2/3 per cent of the cost is borrowed on a first mortgage. At the end of each plan is listed the effect of rent reductions on net income.

FINANCIAL PLAN NO. 1

Investment Cost:

Cost of land.....	\$ 400,000
Cost of building.....	600,000
Cost of financing, carrying charges during construction, organization expenses, etc.....	135,000
	\$1,135,000

Financing:

First mortgage at 6%.....	\$ 550,000
Equity (cash investment).....	585,000
	\$1,135,000

Income:

Gross from rents.....	\$ 200,000
Expenses:	
Operating.....	\$55,000
Interest on mortgage at 6%, plus amortization at 1%.....	38,500
	93,500
Net income.....	\$ 106,500

Effect of reduction in rents or of percentage of vacancies:

	\$180,000	\$160,000	\$140,000	\$120,000	\$100,000
Gross income.....	\$180,000	\$160,000	\$140,000	\$120,000	\$100,000
Less expenses.....	93,500	93,500	93,500	93,500	93,500
Net income.....	86,500	66,500	46,500	26,500	6,500
Net return on cash investment, in %.....	14.9%	11.4%	8.0%	4.5%	1.1%

FINANCIAL PLAN NO. 2

Investment Cost:	
Cost of land.....	\$ 400,000
Cost of building.....	600,000
Cost of financing, carrying charges during construction, organization expenses, etc.....	135,000
	\$1,135,000
Financing:	
First mortgage at 6%.....	\$ 756,000
Equity (cash investment).....	379,000
	\$1,135,000
Income:	
Gross from rents.....	200,000
Expenses:	
Operating.....	\$55,000
Interest on mortgage at 6% plus amortization at 1%.....	52,920
Net income.....	\$ 92,080

Effect of reduction in rents or of percentage of vacancies:

Gross income.....	\$180,000	\$160,000	\$140,000	\$100,000
Less expenses.....	107,920	107,920	107,920	107,920
Net income.....	72,080	52,080	32,080	12,080
Net return on cash investment, in %.....	19.0%	13.8%	8.4%	3.2%

6. *Sources of financing.*—Having decided upon the method of financing, the next step is to choose a source of the mortgage financing. This cannot be done intelligently without some acquaintanceship with the lenders and how they can best be approached for a loan.

The most available sources of mortgage money on business property are lending institutions and investment bankers. Money may also be obtained from private individuals and trustees. Applications for loans may be made direct to the lender or through a mortgage broker.

7. *The mortgage broker.*—The mortgage broker is a man who specializes in obtaining loans for borrowers. He brings borrowers and lenders together, for which service he receives a commission from the borrower. It is very often more advisable to negotiate for a loan through a mortgage broker because he knows the peculiarities of the lenders. He knows also the types of property that they are willing to lend on and how large a loan certain lenders will make on various types of property. The mortgage broker has built up friendly relations with lenders. He has the entrée, and knows how to present an application for a loan so that it will attract the attention of the lender. His judgment, if he knows his business, is respected by lenders as well as by borrowers.

The borrower having recourse to a broker is generally bound by a written or oral contract to pay him a commission, usually one per cent, for procuring a loan or for procuring the acceptance of a loan. To earn his commission, the broker must see to it that the loan is actually made, or if not, that the failure is due to the borrower. If the broker is engaged to procure the acceptance of a loan, he need merely bring a lender "ready, willing, and able" to make the loan on the terms of the borrower, even though the loan is never made.

The mortgage broker may render very valuable service to the borrower by giving advice on mortgage matters and by sitting in at the closing of the loan.

The differences that often arise between borrowers and lenders at the closing can be straightened out by an experienced and diplomatic mortgage broker.

8. *Savings and commercial banks.*—The savings banks are a large and very fertile source of real estate credit. They lend on all types of income-producing property except, in some instances, special-purpose buildings such as clubs, theaters, and hotels. The savings banks in the smaller towns specialize on loans in their immediate vicinity, while the banks in large cities are more or less free-lance lenders in the community as a whole.

The Federal Reserve Act and the various state laws allow a certain latitude to commercial banks in making mortgage loans. The McFadden Amendment permits a national or member bank to lend on real estate, when the loan is secured by a first mortgage on real property located within the federal reserve district in which the lending bank is situated, or within a 100-mile radius of the bank. The loan cannot be for longer than five years. Commercial banks can, therefore, be looked upon as a possible source of real estate credit.

A Canadian chartered bank is prohibited from lending money on real estate, but it may take a mortgage on real estate, by way of additional security, for debts contracted to the bank in the course of its business.

9. *Life insurance and mortgage companies.*—Life insurance companies, like savings banks, are large

lenders of mortgage money. They do not, however, restrict their lending to the vicinity of the home office. Many of the large insurance companies have money out on mortgage in almost every state in the Union.

Mortgage companies are corporations formed under the laws of the various states for the purpose of employing their capital in first-mortgage lending. They are able to lend many times the total of their net capital by buying mortgages, pledging these mortgages with a trustee, and issuing their bonds against them to the investing public. Almost all of the mortgage companies are in the business of reselling mortgages or guaranteed mortgages.

The mortgage companies lend on high-grade residential and business properties throughout the country. Many of them are lending in at least thirty-five of the forty-eight states. Some specialize in certain sections of the country and in only certain types of mortgages.

10. *Title and trust companies.*—Title companies are entering the mortgage-banking field and are operating very much as are the mortgage companies. They make large construction and permanent loans on high-class business and residential property located in the vicinity of the company's office.

Trust companies, in the administration of trust funds, and the trust departments of commercial banks, in like capacity, are extensive lenders on mortgages. The laws which regulate the administra-

tion of trust funds are very similar to those regulating the investments of savings banks and insurance companies. In most cases, real estate is preferred as security for a loan.

Not only trust companies, but also private or individual trustees, furnish money for the financing of real estate. Individual estates and the funds of some educational, religious, and charitable institutions, through their trustees, are available in part, if not almost entirely, for real estate purposes.

11. *Private lenders.*—Private lenders were the first group of importance in mortgage financing, and are still active, though in a different way. Their efforts are now collective, where previously they were individual. This is the result of a demand for greatly increased amounts in the financing of real estate. In the past, \$100,000, \$50,000, or even \$40,000 was a large sum for any business to ask as a real estate loan. Today, many corporations are borrowing amounts in the millions. There are few lenders who can or who are willing to lend that much to an individual. Banks and lending institutions, by pooling the small savings of many, have built up the large sums that are loaned to business.

Another trend in real estate and business financing is seen in the service of the investment banker, who splits up a loan into the convenient units known as bonds. Through the sale of first-mortgage bonds, thousands of individual lenders and investors are united in financing business real estate purchases.

12. *How to apply for a loan.*—If the business man has contacts with lenders or lending institutions, negotiations can be carried on directly. If not, they should be carried on through a mortgage broker. If the loan is large enough—\$1,000,000 or more—and if the business is established and well known, a public offering of bonds can be made through an investment banker.

In any event, an application for the loan must be filed, whether it be with a private lender, lending institution, or investment banker. This application gives, as necessary information, the amount of the loan, the nature of the security, the rate of interest, the manner of payment of principal, the maturity date, a description of property, a description of buildings and improvements, a statement in regard to leases and rentals, and an itemized statement of operating expenses and taxes. The application is presented to the lender with the plans and specifications of any building that is to be constructed. The lender goes over the application, has the property appraised, checks the credit rating of the borrower, and grants or refuses the loan on the basis of the data thus acquired.

The fact that a loan is refused is not necessarily an indication that the venture is unworthy. It may be that the lender has reached a limit of loans for that type of property, or that he does not like its location, or that the layout of the proposed building is not good, in his estimation. A lender often can

be persuaded to make the loan, by altering the plans or by choosing another location.

13. *The lease as a method of financing.*—From the business standpoint, the lease is a very desirable method of handling the real estate problem. A desirable location may be leased for a long period. This gives possession and use of the property, which is what the business man wants. The leasing of property requires no great investment, since the right to use the property is paid for in the form of rent rather than of a purchase price or lump sum. If every business had to raise the capital necessary to buy outright all of its locations, many businesses would never be started. Leasing of property, instead of buying, can be very highly recommended from the standpoint of careful financing.

An interesting side light on this question comes from the practice of the chain-store organizations, the majority of whom rent rather than build. They frankly admit that one reason for following the policy of renting is their desire to avoid the worries and expense incidental to setting up a real estate department for the chain. On the other hand, many chain stores want a standardized front to their buildings, by which the public has come to identify the organization, and this requirement of their publicity policy often makes it necessary to purchase and remodel. Even so, the entanglements of heavy investments in real estate are avoided, wherever the organization can arrange differently.

14. *What is a fair rental?*—Studies have been made on behalf of retail businesses to determine what percentage of gross receipts should be assigned to the payment of rent. These figures are fairly well established for certain types of business, particularly if they are applied over a considerable period, or perhaps the entire time of the lease.

The Bureau of Business Research, of Northwestern University, made a study of 143 meat stores to ascertain how much rent could be paid in that class of business. The study revealed that the average rent paid by these stores was 2.2 per cent of sales. The Harvard Bureau made a similar study of 340 department stores, which showed the following results:

Net Sales	Rent in % of Net Sales
\$1,000,000 to \$4,000,000.....	2.7%
\$4,000,000 to \$9,000,000.....	3.2%
\$10,000,000 or over.....	3.5%

Thomas P. Danahey, a property management expert of Detroit, gives these typical percentages:

Line of Business	Percentage for Rent
Art shops:	
Curios.....	10
Gifts.....	10-10.5
Handcraft and linens.....	12.5
Oriental, wholesale.....	2
Oriental, retail.....	10
Russian.....	12.5
Automobile accessories.....	10

Automobile agency	2
Barber shop	10-15
Books and stationery	10
Books (second-hand)	15
Beauty parlor, service	25
Beauty parlor, merchandise	10
Business school	20
Candy and refectory	10
Cigars	6-8
Cigars and tobacco	7-10
Cigars, tobacco, and newsstand	12.5
Department stores	3; 4, high
Drugs and toilet preparations:	
Ordinary	8-10; average, 8; high, 11
Cut rate	7
Florists	10-15
Furs	10
Furniture (including desks and office furniture)	5-7
Garage, storage	50
Grocery stores, retail	10; average 4.1
Haberdashery—sales of \$100,000	10
Haberdashery—sales of \$125,000	8
Haberdashery—sales over \$125,000	6
Hardware stores	high, 6; low, 3.8
Hosiery and knit goods	10
Jewelry stores	5.4
Ladies' waists and underwear	10
Men's clothing	6-8
Credit clothing	8
Men's furnishings	10-12
Men's hats—general	8
Low-price volume business	6-7
Men's wear	5
Millinery	10-12
Pianos, phonographs, musical instruments	15
Restaurants	10-12
Shoes:	
Men's, women's, children's (mixed prices)	8-10
Men's (mixed prices)	6-8
1 or 2-price, volume business	5-6
Women's (mixed prices)	8-10
1 or 2-price, volume business	5-6
Specialty stores (non-advertising)	8
Sporting goods	5
Surgery	50
Tea room	10
Theaters and hotels	9
Transfer and storage	50
Trunks and leather goods	10-12
Trust company (entire gross receipts)	5
Women's cloaks and suits	6-10
5-10c chain stores (non-advertising)	5

In leasing, it is possible to select sites that may be suitable for later purchase, if this should become desirable. Superfluous space may be subleased to other retailers. Many economical and advantageous leases of this character are made by retail organizations maintaining an alert real estate department.

REVIEW

Describe the methods of financing real estate.

List and discuss the various sources of financing.

How would you proceed to apply for a loan, and where?

What is the function of the lease in real estate financing?

Give examples of the rentals which the average retail firm can afford to pay.

CHAPTER VIII

REAL ESTATE CONTRACTS

1. *Contracts must be written, explicit, and complete.*—When the buyer and the seller of real property have come to an agreement as to price and terms, that agreement is set forth in written form. Reducing the contract to writing is not a mere matter of choice or expediency. Statutes of fraud in force in the several states include contracts for the sale of real property among those agreements which may not be enforced in a court of law unless they are reduced to writing and signed by the parties to be charged. Since either the buyer or the seller may wish to hold the other to the terms of the agreement, both are proper parties to the contract.

Inasmuch as this document is the foundation upon which much of the subsequent process of transferring title rests, no care should be omitted to make sure that it expresses exactly the meaning of the parties, that it contains no ambiguities and, particularly, that its performance is well within the probable ability of the respective parties.

While the statutes requiring contracts for the sale of real property to be in writing usually go no farther than to establish the bare fundamentals of the writ-

ing, practical considerations dictate that it be explicit and complete. It is to be remembered that prior to the passage of title, disputes will usually find the contract exerting an important bearing upon the rights of the parties, and its form and content should be such that, when the contract is offered in court, it speaks for itself fully and without the need of extrinsic evidence to make it complete. It is the business of the courts to enforce contracts—not to make them. Hence, in a case involving the giving of a purchase-money mortgage, where the contract states the amount of the mortgage but not the term for which it is to run, there is the danger that it will be held unenforceable, the full terms of the agreement between the parties being manifestly incomplete.

2. *Power of attorney*.—Property owners frequently desire to authorize the sale of real estate, but do not or cannot personally take care of the details. This task may be delegated by executing a power of attorney, which should “make, constitute, and appoint” some individual as an attorney-in-fact. The instrument should set forth exactly what the agent is authorized to do. If it states that the attorney-in-fact is authorized “to sell and convey,” this does not allow the agent to lease or mortgage. Only if the instrument allows liberal powers, is it possible for the attorney to act *carte blanche*.

3. *The contract of sale*.—The most important of the contracts affecting real estate is the ordinary contract of sale, which constitutes the formal starting-

point in practically all transfers of title effected by deed. Another form of the real estate contract for conditional sales agreement is the land contract, or, as it is sometimes called, the installment contract.

While not as generally used as the contract of sale, the installment sales contract is frequently employed by developers in selling unimproved lots in a subdivision, and sometimes in the sale of houses. The land contract may also be used to advantage in the sale of farm property, or in other cases where the purchaser is unable to put much money into the property at the time of purchase.

By the terms of a land contract, the seller agrees to sell property at a certain price, accepting a down payment and agreeing to accept the balance in installments, payable at stipulated periods with interest on the unpaid balance, until such time as the total purchase price has been paid in. As soon as the final payment has been made, the seller agrees to deliver to the purchaser a deed to the premises. The seller thus retains the legal title, the purchaser having only an equitable interest until delivery of the deed.

This interest may be troublesome, however, if the purchaser enters into possession of the property and later defaults on the contract. The seller must go through a complicated ejectment action to remove him. In order to guard against this contingency, the contract should contain a clause, making the relationship that of landlord and tenant until the title passes. The same thing may be effected by a separate lease.

The purchaser now going into possession as a tenant may be removed by the quicker processes available to a landlord in case the tenant defaults. The seller is thus enabled to repossess the property, with a minimum of delay and expense, in the event of a default.

4. *Contract of exchange.*—The contract of exchange differs little from the contract of sale, except that there are two sellers and two buyers, and the money which passes equals the difference between the values of the properties exchanged. Since there are two buyers and two sellers, each usually takes title to the property accepted in exchange, subject to existing mortgages. In general, the same provisions of the law of contracts hold in the contract of exchange as hold in the contract of sale.

5. *Options and binders.*—An option is an agreement or simple contract entered into by two or more parties, which gives the right, within a specified time, to do or refrain from doing a certain act. As used in connection with real estate transactions, an option gives to the holder the right to buy property within a certain time at a certain price. Unless an option is founded upon some valuable consideration, it is nugatory and constitutes merely an unenforceable promise. It is preferable to have a formal contract drawn and attached to the option, so that there can be no misunderstanding.

A binder is an agreement or simple contract entered into by two or more parties, providing that at

a certain time, in the future, a formal contract will be entered into to do or refrain from doing a certain thing. A binder, like an option and a contract, must be founded upon consideration. A binder is a contract which can be enforced by either party, while an option can be enforced only by the holder. The binder is a rather dangerous instrument, since very little can be based upon it.

6. *Form of the contract.*—An analysis of the form of the contract shows that it is divisible into six general sections, as follows:

- (a) The statement of parties
- (b) A description of the property
- (c) The financial terms
- (d) The time and place of closing
- (e) Miscellaneous provisions
- (f) Signatures

A common form of contract is the following:

CONTRACT

AGREEMENT made the day of
 in the year one thousand nine hun-
 dred and Between
 of the first part
 and of the second part, in
 manner following: The said part of the first part, in
 consideration of the sum of
 to be fully paid as hereinafter mentioned, hereby agree
 to sell unto the said part of the second part

And the said part of the second part hereby agree
 to purchase said premises at the said consideration of

CONTRACT (*Continued*)

Dollars, and to pay the same as follows:.....

And the said part of the first part, on receiving such payment at the time and in the manner above mentioned, shall, at own proper costs and expenses, execute, acknowledge and deliver, to said part of the second part, or to assigns, a proper deed containing a general warranty and the usual full covenants for the conveying and assuring to them, the fee simple of the said premises, free from all incumbrance..... and which deed shall be delivered on the day of 19..... at o'clock..... M., at the office No. in the City of.....

The risk of loss or damage by fire prior to the completion of this contract is hereby assumed by the part of the part. The rents of the said premises (if any) shall be adjusted, apportioned and allowed up to the day of taking title.

And it is understood that the stipulations aforesaid are to apply to and bind the heirs, executors, administrators and assigns of the respective parties.

Witness the signatures and seals of the above parties.
In Presence of.....
.....County of ss:

On this day of..... one thousand nine hundred and..... before me personally came to me known, and known to me to be the individual described in and who executed the foregoing instrument, and he thereupon duly acknowledged to me that he had executed the same.

The contract should be prepared in duplicate, one for each party to the contract. If there are more than two parties, all should have a copy. If the closing of title contemplates the using of an escrow agent, such as a bank or title company, it is advisable, also, to deposit a copy of the contract with the agent.

It is customary and advisable in making a contract to give the place and date of the signing of the contract. While this is not an absolute requirement, fixing the place has a bearing on the jurisdiction of a court called upon to adjudicate between the parties. Furthermore, the date is a memorandum which may be useful in determining vital facts in connection with the contract, such as that of carrying it out within a reasonable time.

While time is not normally the essence of a contract, it may be made so by its terms. If no time is actually set for the closing, it should take place within a reasonable period after the contract is signed. The time and place for the closing should be stated in the contract.

7. Parties to the contract.—After the date, come the names of the parties and their designation as seller and purchaser, together with their respective addresses. If the seller is married, the wife or husband should join in signing the contract, since otherwise the other spouse could not be compelled to release his or her dower or curtesy interest. Failure to get the signature of an interested spouse might

result in the seller's inability to go through with the contract and leave the purchaser only a right of action for damages.

The designation of the parties is followed by the mutual promise of the parties, "The seller agrees to sell and to convey and the purchaser agrees to purchase." This clause represents the offer to sell and to transfer title to the property by delivering such further instruments as are necessary, and the acceptance of the offer with its obligation to pay over the consideration demanded on the specified terms and conditions. The mutual promises of the seller to sell and of the purchaser to buy are at law sufficient consideration to make the contract enforceable.

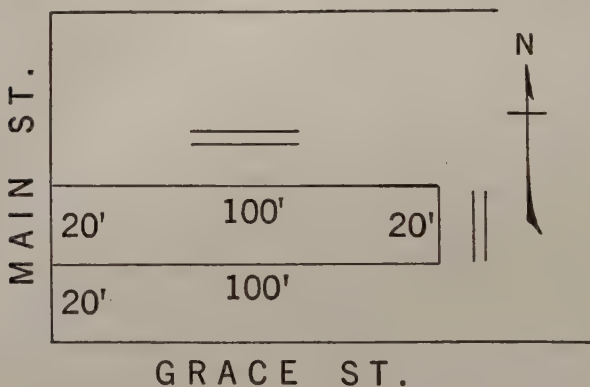
8. *The description.*—The description of the property naturally is of great importance. Too often, parties who insist on the most accurate surveyor's or legal descriptions, in a deed, are content with a mere identification of the property, in the contract. At times, the legal description is not available when the contract is drawn up, but, whenever possible, the same description should be used in the contract as appears in the deed.

A description by a regularly recognized street number, such as, "known as and by the number 230 West 34th Street," might be sufficient for a contract to buy or sell a house, but should never be used in describing a vacant plot or a valuable piece of property.

In some jurisdictions, maps of realty holdings and

subdivisions have been admitted to record in the proper public offices. In such cases, a proper description would refer to the plot by the lot, block, and subdivision numbers, and by the name of the political unit as designated on the recorded plates or maps.

The metes and bounds description is the one commonly used. It is rather complicated, but describes most accurately the property to be conveyed. The following is a typical metes and bounds description:



. . . all that lot or parcel of land with buildings and improvements thereon . . . described as follows:

Beginning at a point on the easterly side of Main Street, 20 feet northerly from the corner formed by the intersection of the easterly side of Main Street and the northerly side of Grace Street; Thence in an easterly direction parallel to the northerly side of Grace Street 100 feet, thence in a northerly direction parallel to the easterly side of Main Street 40 feet, thence in a westerly direction parallel to the northerly side of Grace Street 100 feet to the easterly side of Main Street, thence in a southerly direction

along the easterly side of Main Street 40 feet to the point or place of beginning.

9. *Financial and miscellaneous items.*—Every part of a real estate contract is important. There is no contract, except for consideration. The financial statement outlines the terms. It states, first, the amount to be paid on signing the contract; next, the amount to be paid at the closing. It also provides for purchase-money mortgages, if such are to be given. Existing mortgages, encumbrances, and other details, such as apportionment of rents, insurance, taxes, etc., must also be provided for in the contract.

The time and place for the closing of the contract are other important items. Then follow the miscellaneous provisions that either buyer or seller find necessary to insert. At the end are the signatures of both the buyer and the seller. If the contract is a large or an important one, it should be witnessed. It need not be acknowledged, since it is very seldom recorded.

10. *Remedies in case of default.*—The seller promises to the purchaser that he will not dispose of the property or encumber it in any way except as mentioned and set forth in the contract, and that at the time designated, he will deliver to the purchaser a deed of the said premises. If he fails to do this, the purchaser has three remedies:

- (a) The purchaser may bring an action for specific performance. By this is meant forcing the

seller to go through with the transaction under the original tenor of the contract of sale.

- (b) He may sue the seller for the difference between the contract price and the market price at the time and place of closing. For example, the contract price may have been \$30,000, but at the time of title closing the property may be worth \$40,000. If the seller refuses to convey, the purchaser can sue him for this difference in price, which in the present example would be \$10,000.
- (c) The purchaser can sue the seller for the return of deposit and a reasonable sum for the searching and examination of title, which does not include any legal fees incurred by the purchaser.

The buyer, on his part, promises to carry out his half of the contract and to pay over, at the time of closing, the balance of cash required, and to execute and deliver any purchase-money mortgage or mortgages in connection therewith. Should he fail, the seller has three rights:

- (a) An action for specific performance
- (b) A suit for the difference between the market price and the contract price
- (c) Rescission of the contract and retention of the purchaser's deposit.

Sometimes the situation arises wherein the seller, although perfectly willing to convey title, is unable to do so through some fault not his own, such as the discovery of a defect that renders the title unmarketable. In such a case, the purchaser can only sue for

the return of the deposit and for the expenses of searching title.

11. *Specific performance as a remedy.*—Specific performance is advisable only when the case is clean cut. For example, if the purchaser were to bring action against the seller for specific performance, when the seller had already conveyed the property to some other person, the only way to get a decision in the purchaser's favor would be to join the seller and the new purchaser in the action and establish collusion in an effort to defraud. This is a difficult task, as fraud, especially where supposedly innocent parties are involved, is a very difficult thing to prove.

On the other hand, the seller may bring action against the purchaser for specific performance and obtain a judgment demanding that the purchaser buy, but, if there is no cash in the purchaser's hands to complete the transaction, it is not a particularly successful action. It is equally difficult for either party to sue for the difference between the contract price and the market price, because it must be proved, by expert testimony, that there actually was the difference existing between these prices, as claimed, and expert appraisers seldom agree in their valuations when court action is involved.

The person holding an option is the only party to that form of contract who has the right to demand enforcement. The holder of an option may sue for, and recover, damages directly arising from default of the vendor, or the holder of the option may bring

action for specific performance if the owner of the property refuses to go through with the contract. If a binder is defaulted by either purchaser or seller, the same remedies are available to the injured party as are available in a contract of sale.

The seller of real estate under an installment contract may dispossess the purchaser in case of default. The lease agreement leaves the seller in possession of the property, and stipulates that whatever has been paid in on the contract shall be considered as rent, and that the purchaser can be dispossessed in the same way as a tenant, under a lease, for non-payment of rent. In some jurisdictions, however, it is necessary to foreclose an installment contract in the same manner as a mortgage.

12. *Real estate contracts in Canada.*—In Canada, if a vendor contracts to sell land without any protecting condition as to title, he must make out a good title in fee simple in possession. Any well-drawn agreement will, accordingly, contain provisions enabling the vendor to cancel, if he cannot make title. And in some provinces, as in Ontario, certain provisions are, by statute, implied in every contract for the sale and purchase of land, unless otherwise stipulated. The Ontario provisions are as given in the following tabulation:

- (a) The vendor shall not be bound to produce any abstract of title, deed, copies of deeds, or other evidence of title, except such as are in his possession or control.

- (b) The purchaser shall search the title at his own expense and shall make his objections thereto in writing within thirty days from the making of the contract.
- (c) The vendor shall have thirty days in which to remove any objection made to the title, but, if he is unable or unwilling to remove any objection which the purchaser is not willing to waive, he may cancel the contract and return any deposit made but shall not be otherwise liable to the purchaser.
- (d) Taxes, local improvement rates, insurance premiums, rents and interest, shall be adjusted as at the date of closing.
- (e) The conveyance shall be prepared by the vendor, and the mortgage, if any, by the purchaser, and the purchaser shall bear the expense of registration of the deed and the vendor shall bear the expense of the registration of the mortgage, if any.
- (f) The purchaser shall be entitled to possession, or the receipt of rents and profits, upon the closing of the transaction.

In many provinces, the "offer to purchase" form is used; that is to say, the purchaser makes an offer containing all the terms he thinks will be accepted, and the contract is then completed by the signature of the vendor and by his acceptance in general terms.

It should be noted that, in the absence of an agreement, all risks are assumed by the purchaser. If the building burns down before closing, the loss is the purchaser's, and he cannot claim a reduction in the purchase price. A well-drawn agreement would pro-

vide for such a contingency, but no protection clause is found in the ordinary printed form so much in use.

Another clause frequently found in the printed forms reads: "The purchaser accepts the property, subject to the restrictions and covenants that run with the land." In the absence of such a clause, the existence of building restrictions is sufficient ground for the purchaser to refuse to complete the sale. The vendor and the real estate agent are accordingly anxious to insert the clause, but the purchaser should insist that the restrictions which he is asked to assume be set out in full in the agreement.

It is, of course, of great importance that the amount and terms of any mortgage to be assumed by the purchaser be set out in detail, and, if any mortgage is to be given to the vendor to secure part of the purchase price, that full particulars of the terms of payment be given; otherwise, the agreement may be too vague to enforce.

If time is the essence of the agreement, failure to close the sale on the day stipulated may prevent specific performance of the agreement. Extension of the time of closing does not necessarily waive the agreement to make time the essence, but verbal extensions are dangerous in view of the requirements of the statute of frauds.

REVIEW

Must a contract for the sale of real estate be in writing?

Explain how the right to contract for the sale of real estate may be given to another.

State the difference between a land contract and a contract of sale.

Describe an option; a binder.

List the chief divisions of a contract.

What remedies have the parties to a contract in case of default?

CHAPTER IX

THE TRANSFER OF REAL PROPERTY

1. *Early systems of land ownership.*—One of the incidents of ownership of property is the right to dispose of it. The history of the development of this right, and of the methods of exercising it, is intimately connected with the development of laws affecting real property, interests in real property, and limitations upon ownership. In earliest times, when ownership and possession were dependent merely upon the physical power of the individual to maintain his rights against all comers, transfer was accomplished when someone who was stronger than the possessor removed the weaker and took possession.

The feudal system developed on a similarly physical basis. The sovereign owned the land and held it by the strength of his tenants, joined together and bound to support his ownership. The king parceled out the land to his lords, who in turn subdivided it among their retainers. The only one having title to the land was the king; the others had only a feud, or a right to possess the land during the pleasure of the overlord.

The feudal system of land ownership gradually

gave way to the allodial system. This transition was characterized by a strengthening of the rights of individual ownership. As the right of the individual to own land developed, it became necessary to devise ways and means by which he could transfer his interest in real property. This transfer of interest in real property was at first effected by symbolic transfer, and later by deed.

Symbolic transfers were made by the owner's giving the purchaser some part of the property, such as a clod of the earth, sometimes accompanied by handing him a rod or other symbol of authority. This was done in the presence of witnesses. Transferring ownership by delivery of possession in the presence of witnesses gave rise to abuse and even to fraud, particularly when the witnesses to a previous transfer could not be found, or when their testimony on material points could be influenced by corruption. This was one very important reason for passing the statute of frauds, providing, among other things, that no action can be brought on a contract for the transfer of any interest in real property unless that contract is in writing.

2. *Present-day methods of transfer.*—Not all transfers of real estate are made as the result of a sale. Other methods are recognized by modern law, materially widening the scope of our subject. In business practice, however, there are four principal methods whereby title to real estate can be transferred:

- (a) By descent or statutory distribution
- (b) By will
- (c) By voluntary alienation
- (d) By involuntary alienation

3. *Transfer by descent.*—This method applies to the transfer of property of a person dying intestate, without leaving a will. The law intervenes to set up a method of distributing the estate of the deceased in as fair a manner as possible.

Real property passes to the heirs without the intervention of an administrator. Personal property is intrusted to an administrator, who uses any part of it necessary to pay the debts of the decedent and distributes the remainder, as the law provides, to the next of kin. Should the personal property be insufficient to pay the debts, the administrator may, by order of the court, sell as much of the real property as is required, distributing the remainder as the law directs.

While the laws of the different states vary considerably on this point, the general method of taking real property is covered in the following three items:

- (a) Descending—to the children or descendants
- (b) Ascending—to father, mother, or both, if the decedent has no children
- (c) Collateral—If the decedent has no children and no father or mother living, the real property passes outward to his brothers and sisters or, lacking these, to his next of kin by degree of relationship

In many provinces of Canada, title to real estate does not pass direct to the heirs or devisees on the death of the owner. The executor or administrator takes title and keeps title for a definite period, usually three years, at the end of which time the property automatically shifts to the person entitled, unless the executor or administrator takes steps to prevent its shifting, as he may do under certain circumstances. It is, accordingly, dangerous to purchase from a devisee or an heir within the statutory period, as the purchaser may find later that he has taken the property subject to the debts of the estate.

4. *Statute of descent*.—Another provision generally found in all laws of estates is that property shall pass *per stirpes* and not *per capita*. *Per stirpes*, or “by the root,” merely means that those in the same degree of relationship share equally in the estate, while descendants or legal representatives of those heirs succeed to the interest of the heir which they represent.

For example, if a man dies intestate, leaving three sons, each son will receive one-third of his estate, subject to the dower interest of the widow, if living. But if one of the three sons had died prior to the death of his father, and only two sons are left, the estate will pass one-third to each of the living sons, and one-third to any heirs of the deceased son. If the deceased son had three children, each child will get one-ninth of his grandfather’s estate.

Had the decedent left a will, however, it would have been possible to direct a per capita distribution, in which case each heir would receive one-fifth of the estate. These methods of passing title by descent or by will are universal, except in cases where the deceased is survived only by grandchildren or by heirs of more distant relationship.

Practically every jurisdiction has, in simple codified form, statutes prescribing the manner in which intestate property shall be distributed. In most of the Canadian provinces, if a man dies intestate, leaving a wife and children, the wife will take one-third and the children two-thirds. Recent amendments, in some provinces, give one-half to the widow and one-half to the child, when there is only one child.

5. *The wife's rights.*—It will be noticed that a wife, in the distribution of the estate, has the status of neither an heir nor next of kin. Her right to succeed to an interest in the property is fixed by statute in the various jurisdictions. In many instances, she is given a dower right in the estate along the line of the old common law, which allowed her a life interest in one-third of the decedent's real property. In addition, she was assigned a fixed interest in the personal property, including the use of the homestead for one year, or, in lieu thereof, an allowance of personal property sufficient for one year's support.

Due to the increasing independence and legal equality of women, there is a tendency to give her

a more complete interest in her husband's estate. Community property rights and the new decedent's estate law in New York abolish the right of dower and curtesy, and give either surviving spouse a fuller interest in the total estate.

The western provinces of Canada—British Columbia, Alberta, Saskatchewan, and Manitoba—have done away with dower, but have preserved certain rights of the widow. In the case of a "homestead," every disposition by a married man or woman is invalid, unless the wife or husband consents, in writing, to such disposition.

6. *Wills*.—A real estate owner has the right to give to whomever he pleases, subject to certain statutory limitations, all property held at the time of death. The most common limitations are that the grantor cannot give away more than half of his property, and that the surviving spouse has a certain statutory interest in the estate, in the form of dower, curtesy, or an outright share.

A recent Ontario statute, known as the Dependent Relief Act, interferes, to some extent, with the right to leave property by will. The wife or husband or child may apply to the court for an allowance, when the testator has so disposed of his property that adequate provision has not been made for the maintenance of his dependents.

7. *Voluntary alienation*.—Transfer of title by voluntary alienation means transfer by gift or sale. The principal limitation placed upon the right to transfer

ownership in this manner is the requirement of good faith in dealing with creditors who might wish to satisfy their claims by recourse to the debtor's real property. In addition, certain rights are usually given to wives, such as the dower. Some jurisdictions also limit the right to transfer when it is attempted to avoid estate taxes in anticipation of death.

8. *The contract.*—In the transfer of real property by sale, the first step is ordinarily the contract to sell, which must be in writing. The elements of a real estate contract are the same as for any other kind, namely:

- (a) Competent parties
- (b) An offer and acceptance
- (c) Legal consideration
- (d) Legality of object

To be a competent party, one must be of sound mind and of lawful age. A minor might sign a contract to sell real estate and spend the money received for it. When he reached the age of majority, he could disaffirm the contract and the court would order the return of the property to him. There is a difference between the minor's rights of disaffirmance of sales contracts for real estate and for personal property. The latter he may disaffirm during his legal infancy, but the sales contract for real estate cannot be disaffirmed until he becomes of age.

It naturally follows that, when buying real estate from one who is legally an infant, the buyer will

hold both the real estate and the income therefrom only as a trustee until the infant arrives at age and can affirm or disaffirm the contract.

9. *Consideration.*—The mutual promises of the seller to sell and of the buyer to purchase and to pay a certain price are sufficient to satisfy the requirements of the law for consideration. It is customary, however, for the buyer to pay a part of the agreed purchase price at the time of signing the contract and the balance at closing the title.

The contract to sell ordinarily does not give possession, but, by agreement, title to the property passes through delivering the deed. The contract may pass possession, if that is the intent of the parties, as in the case of a contract calling for payments in installments. In that case, possession is usually turned over at the signing of the contract or shortly thereafter, although title does not actually pass until after all of the installments have been made and the deed is delivered.

In installment sales, it is advisable for the owner to execute with the purchaser, coincidentally with the contract, a letting agreement, which sets up the relationship of landlord and tenant between the parties during the time when the title remains in the seller, although the purchaser is in possession. This may be a separate agreement, but is usually inserted as a clause in the contract itself. This special agreement is necessary to avoid the legal complications which arise when a purchaser is permitted to enter

into possession of property before he has legal title to it.

From the standpoint of contracting parties, it is well to remember that a contract for the sale of real property is binding on the parties, their heirs, legal representatives, assigns, or successors.

10. *The deed*.—The instrument which operates to transfer title to real estate is known as the deed. It is a formal instrument, under seal, which is prima facie evidence that actual consideration has passed.

The actual transfer of title takes place only upon intentional delivery of the deed, not upon the signing of it, and the law requires that the party signing the deed must be competent at the time of such delivery. Great care should be exercised to see that all terms agreed upon between the parties have been fully complied with before the delivery of the deed, since the deed specifically acknowledges the full performance of such terms. The deed need only be signed by the party conveying title to the property, in the presence of witnesses.

11. *Closing of title*.—Before closing title, a survey of the property should be made to ascertain the exact dimensions of the plot and to ascertain if the description as given in the deed is accurate or if there are any encroachments. While the survey is being made, the title is being searched and examined by a title company or by a lawyer, to ascertain if it contains any flaws. The actual closing takes place at the time and place set in the contract for the delivery of the

deed. At that time, the balance of the purchase price is paid and any adjustments are made.

Before closing a real estate deal, it will be well to check over the following list to avoid omissions, errors, and misunderstanding:

- (a) Sellers and purchasers, or their respective attorneys or agents, must approve the closing statement.
- (b) A letter should be obtained from the mortgage company, financial institution, or bond house, showing the exact status of the mortgage or trust deed. Such letters should also state, either that the mortgage is not in default, or if so, in what respect.
- (c) All mortgages should be examined to ascertain whether the mortgage gives to any person or corporation the right to take possession of, and to operate, the premises, during the extension of the mortgage indebtedness.
- (d) All mortgages should be examined to ascertain whether they contain any provisions with reference to amortization, sinking fund, or other unusual provisions.
- (e) What are the zoning restrictions and privileges?
- (f) Is the building built in conformity with the restrictions and in conformity with building ordinances?
- (g) Are there any easements?

Papers to be secured:

- (a) Leases
- (b) Paid principal notes on mortgages
- (c) Paid interest notes on mortgages
- (d) Guarantee policies
- (e) Insurance policies

- (f) Receipt for insurance policies
- (g) Assignment of insurance policies
- (h) Tax bills
- (i) Assessment bills
- (j) Survey
- (k) Receipt for cash
- (l) Statement of renting agent
- (m) Service contracts
- (n) Orders to all tenants to pay rent to purchaser
- (o) Letter to mortgage houses
- (p) Water, light, and power bills
- (q) Extension agreements of existing loans

12. *The survey.*—The survey is made so that the purchaser can be assured that he is getting all of the land for which he bargained. A detailed report usually accompanies the survey, describing the buildings erected on the plot, and a statement is given of any encroachments on the street or on adjoining property, or of other properties on the property being purchased.

Customs vary in different localities as to which party is under obligation to furnish the survey and other evidences of title. If there is possibility of disagreement as to the obligation, the contract should state definitely on whom the responsibility falls. Otherwise, the seller is obliged only to deliver the deed, and the purchaser, for his own protection, will be compelled to secure all evidence of the extent of the property and the state of the title.

13. *Search of title.*—The condition or status of the seller's title is determined by having it searched. There are two objectives in this process. First, to

trace the title from the original granting source, usually a government, through all parties to whom it passed by any method whatever. Second, to determine what liens or encumbrances now exist against the property. The first part of the search establishes whether or not there is a perfect unbroken chain of title sufficient to vest ownership in the seller of the property. The second part determines whether there are any public or private rights adverse to the seller's title existing at the time of the intended transfer. The report of such a search is known as an abstract of title. Originally conducted by individual attorneys, the business of searching and examining titles has passed largely into the hands of abstract or title companies, who render services for which the average attorney is unequipped.

In earlier times, actual possession of property was notice to all the world that the possessor claimed or had some title to the property. It is manifestly impossible, under modern conditions, for the average owner of property to be in actual physical possession of all of the real estate which he owns, and some method of so-called constructive notice of ownership had to be devised as a substitute for actual notice. To accomplish this purpose, recording acts have been enacted in all jurisdictions. Such instruments, properly executed and recorded, are constructive notice that the grantee of record is the owner, even though he is not necessarily in possession of the property.

Consequently, a deed, a mortgage, a lease, a will,

a lien, or any public or private claim, when entered upon the public record, gives legal notice of the title or interest of all parties. It is in these public records, that examiners of title make their search.

The great volume of real estate transfers and the complexity of searching, examining, and insuring titles have resulted in a large transfer of title examination from individuals to companies having large staffs of expert examiners. Such companies accumulate, in an orderly fashion, complete abstracts of every record affecting title to land in the communities which they serve. These records include accurate information on every public and private source of information.

Even with all these sources of information, there is still danger of error. When mistakes occur, the responsible abstractor or title company will usually make good any losses resulting from their errors. Even when no error is made by the examiner, there are many things which may affect the title and perhaps make it unmarketable. Almost the only way to guard against a latent defect in a title is to have it insured by a title company.

14. *Title searching in Canada.*—In Canada, title insurance is not in general use. Titles are searched by lawyers whose duty it is to report and certify to title.

The complete systems of land registration in force in all the provinces facilitate the work of title searching. Two systems are in force: the old system of

deed registration, and the newer system of title registration, usually called the Land Titles or Torrens system. Where Land Titles Acts are in force, it is not necessary to examine the complete chain of title. The registrar passes upon the validity of each document before it is registered, and the statement in the registry as to ownership is final, subject only to charges or encumbrances expressly set out. A guaranteed and indefeasible title is, in effect, secured upon registration of a deed or transfer from the registered owner.

In Ontario and Manitoba, both systems are in force, but machinery exists for changing land from the old system to the new. In Alberta, Saskatchewan, and the Northwest Territories, the Land Title system only is in force. In the Maritime Provinces, the old system is in general use. The British Columbia system is similar to the old system, with the added feature of a certificate of indefeasible title. Quebec has a registry office system, but the whole system of conveyancing differs from that of any other province. Conveyancing in Quebec is almost entirely in the hands of the notary.

Where the Registry Office system is in force, it is necessary to examine every document on the title, usually from the date of the original grant from the Crown, which is often a long and tedious process. This work is facilitated by the abstract register, which summarizes the chain of title, and an abstract can be obtained, under the signature of the registrar,

which can be made the basis of the search. Every document is registered in duplicate, one copy being retained by the registrar and the other by the registry office. In addition, copies are made in the registry books of every material document, so that it is not necessary to read original documents in every case. A recent Ontario statute has further simplified the task of examining titles by making it unnecessary to examine documents registered over forty years.

15. *Adjustments*.—There are always numerous adjustments to be made between the parties to a real estate transfer, such as allowances on one side or the other for taxes, prepaid insurance, interest on mortgages, rents, water, lights, and on many other items. These adjustments may be made to the day of closing or the day prior to it.

Engaging an escrow agent may simplify the whole process of making adjustments and closing title, since he is a disinterested third party, acting in the capacity of a trustee of the funds. Another advantage in employing an escrow agent is that the seller does not tie up his capital in clearing the title, since he can instruct the escrow agent to use the payments already made.

The following customs in respect to title closings were adopted by the Real Estate Board of New York in 1925:

(a) All adjustments of interest, rents, taxes, water rates, and insurance premiums shall be made as of the day immediately preceding the day on which title is closed.

(b) Interest, taxes, water rates, and insurance shall be computed by the 360-day method, each month representing one-twelfth of the annual charge and each day one-thirtieth of the monthly charge.

(c) Rent shall be computed on the basis of the days in the particular month in which title is closed.

(d) Where the period for which the computation of interest, taxes, water rates and insurance is to be made is more than one month, the elapsed time shall be computed by full months and by the actual number of days in excess of such full months.

Note: Suppose, for example, interest on a mortgage has been paid to March 15 and title closes on June 4, the computation of time for determining the amount of interest to be allowed to the purchaser would be as follows:

March 15 to April 15.....	1 month
April 15 to May 15.....	1 month
May 15 to May 31.....	16 days
May 31 to June 3.....	3 days
Total.....	2 months, 19 days

(e) Where the period for which the computation of interest, taxes, water rates, and insurance is to be made is less than one month, the actual number of days shall be counted, excluding the first day and including the last.

(f) When the time for closing a title is adjourned without any specific provisions as to adjustments, all adjustments shall be made as of the day prior to the adjourned date, and the seller shall not be entitled to interest from the original date, either on the unpaid balance of the purchase price or on any purchase money mortgages.

(g) When the time for closing a title is adjourned under a stipulation that all adjustments are to be made as of original date, the seller shall be entitled to interest at legal rate on the unpaid balance of the purchase price and on any purchase money mortgages from the original date set for closing title.

(h) Whenever the contract provides that taxes are to be apportioned, this shall be deemed to include water charges.

(i) Even if no reference is made in the contract to the liability of purchaser to pay recording tax on a purchase money mortgage and revenue stamps on a purchase money bond, the purchaser shall, nevertheless, be deemed under obligation to pay the same.

(j) If the contract provides that one of the parties is to pay for drawing papers and no charge is stated in the contract, the charge shall be as follows:

A deed	\$10.00
A bond and mortgage.....	20.00
A satisfaction piece	5.00
An assignment of mortgage.....	10.00
A release of part of mortgaged premises.....	15.00

16. *Involuntary alienation.*—Involuntary alienation is a transfer which has been effected by action of law, without the volition of the owner. Proceedings to satisfy liens, such as mortgages, judgments, and the like, usually end in the forced sale of property to satisfy the judgment. Actions of foreclosure are the most common form.

Another type of transfer of real property which takes place by action of law is escheat. This is the automatic passing of real property to the state in case the property owner dies intestate, leaving no heir, surviving spouse, or next of kin.

Eminent domain, like escheat, is a right belonging to the state to seize such property as is needed for public purposes, after paying the fair value of the property. In some jurisdictions, the political unit,

through an excess condemnation proceeding, is allowed to take more property than is needed immediately. Part of this property may even be used for housing purposes. While the property is seized by due process of law, the transfer may be effected against the will of the owner.

Legal title to property may be acquired by long, continued, and uninterrupted possession under some color of title or claim to ownership, if uncontested. Twenty years is the usual time fixed by statute for the uninterrupted possession, and this mode of transfer is known in law as adverse possession. In most provinces of Canada, ten years of adverse possession will extinguish the owner's title.

REVIEW

Compare the feudal and allodial systems of land ownership. List and describe the modern methods of transferring real estate.

Explain the customs that are followed at title closings.

What are the functions of a title company?

What instruments should be brought to the closing by the buyer? By the seller?

Define dower; recording acts; escheat; eminent domain; adverse possession.

CHAPTER X

DEEDS

1. *Transfer of title.*—The methods by which title to real property may be transferred are embraced within three general classifications. By his voluntary act, the owner of real property may effect a transfer of title operative after his death, or he may transfer the title to another person during his lifetime. The former is accomplished by will and the latter by deed. In case an owner of real property dies without leaving a will, statutes of descent in the different states determine to whom title will pass, and the heirs of the owner take title by descent.

Finally, title to real property may be obtained by the state through the exercise of eminent domain. In some instances, title may be obtained by private parties by adverse possession and title may pass from an owner to the public, or to a public party, by dedication or prescription. In this chapter we are considering only the transfer of title by deed—the form of transfer which is met with most frequently.

2. *Requirements of the deed.*—It is possible, again, to separate the requirements of a deed, for the purpose of transferring title, into three divisions. There are, first, those formal requirements which affect the

instrument itself and which concern its validity as an effective instrument. In the second place, there are those requirements pertaining to execution which are designed to insure that the deed is the voluntary act of the grantor and that it bears evidence to that effect. Finally, there are requirements which do not affect the validity of the deed itself, as between the parties, but which are designed for the protection both of owners of real property and of creditors. This last group of requirements embraces the recording of conveyances and the formalities necessary for recording.

3. *Formal requisites of the deed.*—A conveyance of real property must be in writing; it must convey the property to a named grantee who is in existence and competent; and it must adequately describe the property which is the subject of the conveyance. Laws of different states vary as to the effectiveness to be given an instrument which, while properly signed, omits the name of either grantor or grantee in the body of the instrument. In some jurisdictions, it is held that the grantee has an implied authority to complete the deed by insertion of his name. The efficacy of a deed which, while properly signed, does not name the grantor in the body of the instrument is open to question, in some states. No more need be said to emphasize the care that should be used in scrutinizing a deed to make sure that there are no omissions, or errors, in the description of the parties.

The description of the property itself is usually

taken by the conveyancer from the deed by which the seller acquired title. In the case of properties which are insured under a title policy, the description may be made to conform to that of the policy. A deed properly prepared will be carefully compared throughout, in the office of the conveyancer, before it is time for closing the title. Despite the fact that in the vast majority of cases the description will be adequate, it will be worth the while, both of buyer and seller, to go over the description thoroughly and make sure that no errors are present.

When a property is being sold subject to a mortgage, which the buyer assumes and agrees to pay, a recital of this fact will normally be found after the description of the property. Here, again, while this matter should be checked in the office of the conveyancer, the parties should have in mind the material which the deed must contain and make sure that it has not been omitted.

4. *Execution of the deed.*—The first requisite in the execution of a deed is its signing by the grantor or grantors. The chief matters of importance here are to make sure that the signature is in the proper place at the end of the deed and that it is in proper form. When a deed is executed by a person acting under power of attorney from the grantor, the proper form of signature is as follows:

JOHN JONES (the grantor)

By: WILLIAM SMITH, Attorney in Fact.

A corporation, as has been noted, signs the deed by affixing its corporate seal. In addition to this, the name of the corporation is subscribed to the deed, together with the names of the officers who do the subscribing. A corporation's execution of a deed, accordingly, takes a form similar to the following:

Corporate Seal

THE X.Y.Z. CORPORATION

By: JOHN JONES

President

Attest:

ADAM SMITH

Secretary.

A corporate deed usually is accompanied by a copy of the minutes of the meeting at which the right of the officers to execute the deed was approved and the sale authorized. The copy of the minutes is accompanied by the secretary's affidavit. Since a corporation acts through its board of directors and officers, it is well to require the production of an attested copy of the minutes in all cases of corporate transfers, particularly if the sale of real property is not the primary business of the corporation.

In some states, a seal is still required, but this may take the form of a wafer, a scroll, a printed circle bearing the word "Seal," or some other device that meets the requirements of the state's statutes. In all cases where seals are required, it is the better practice to have the instrument bear as many seals as there are grantors.

A majority of the states do not require that a deed be witnessed. Eighteen states require either one or two witnesses. It is the better practice, regardless of strict legal requirements, to have signatures to a deed witnessed. The presence of witnesses on a deed may become most valuable, if the necessity of proving the deed later arises. If the instrument has not been acknowledged and the grantor dies, before acknowledgment, the statement of the witnesses, reciting the due execution of the deed, will be proof to admit to record in lieu of acknowledgment.

In Canada, deeds should be executed under seal. Transfers of property under the Land Titles system do not require seals, except in the case of corporations. The corporate or common seal must be affixed in all instances and the affixing of the seal implies delivery. Witnesses are usually required, as in most provinces an affidavit must be made by the attesting witness before the document can be registered. It is not necessary that the corporation's name appear otherwise than on the seal. The seal is the signature attested in the manner prescribed by the by-laws of the corporation. Many of the Land Titles Acts require proof that the attesting officers are authorized to affix the seal.

5. *Changes and alterations.*—After a deed is drawn, it not infrequently happens that changes or corrections of a minor nature need to be made. For instance, there may be typographical errors, such as transpositions of letters, or possibly a more vital

error, such as the insertion of a wrong direction in the description of the property, as north for south.

Changes and corrections may be made by erasure and by typing in the correct phrasing, or they may be made by pen. Whatever the nature of the change may be, upon execution of the deed, it should be authenticated by the grantor's signing his initials on the margin of the page opposite the alterations. A change, particularly if it enlarges the grantee's interests, is always a matter for suspicion, and the initialing of the changes by the grantor, before or at the time of execution, shows that the changes are his and not those of the purchaser.

6. *Acknowledgment*.—The purpose of acknowledgment is generally to prove the execution of the deed by the grantor's formal declaration of that act to an officer qualified to take acknowledgments. More specifically, it is a formality prerequisite to the recording of the deed. When the deed is executed in the same state in which the land lies, the acknowledgment is normally taken care of, as a matter of form, when the deed is executed. When the grantor executes the deed outside of the state in which the land is situated, he should acknowledge before an official qualified to take acknowledgments in that state. Then, before the deed is forwarded, the certificate of the county clerk, obtainable at a nominal fee, should be attached, verifying the authority of the official taking the acknowledgment. Without this certificate,

the deed executed out of the state will not be admitted to record and a delay is encountered through having to send it back for the proper authentication.

Acknowledgments are used in British Columbia, New Brunswick, Nova Scotia, and Prince Edward Island. In the other provinces, the witness must make an affidavit, proving the execution of the deed; otherwise, it cannot be registered.

7. *Delivery of the deed.*—The final act which gives life to the deed is its delivery. The deed takes effect from the time of delivery. Before it has been delivered, it is merely a piece of writing, with no efficacy, despite the fact that it may have been duly signed, sealed, and acknowledged. Delivery takes place when the deed, properly executed, is given by the grantor to the grantee with intent to pass title. Of course, it may be given to an agent of the grantee by an agent of the grantor and the delivery is often evidenced by the intent of the parties, as when the grantor's counsel may retain it for the purpose of recording it. A deed, fully executed, which finds its way into the possession of the grantee without delivery is inoperative.

The importance of delivery, as completing and giving life to the transaction, may be illustrated by the case of a deed in which a corporation yet to be formed is the grantee. The deed may be drawn and executed by the grantor. There is no grantee in existence and hence the deed at present is a nullity. When the corporation obtains its charter, the deed is then de-

livered to the proper officers. The corporation's title takes effect from the time of delivery, and the writing which had been a nullity is transformed into an effective instrument by the act of delivery.

Since delivery is the act which transfers title to the grantee, the title cannot be revested simply by a return of the deed, under ordinary circumstances. This is particularly true, if the deed has been recorded. In a case where the deed was returned and destroyed prior to recording, it might be held that there was evidence of non-acceptance.

8. *Delivery in escrow.*—In some circumstances, it may be desired that title shall pass to the buyer upon the occurrence of some future event. Normally, the whole transfer of title would be delayed to this time. It is possible, however, to have a deed executed and delivered in the present so as to defer the passing of title to a future date. This is accomplished by delivery in escrow.

The requirements for delivery in escrow are a third person (neither grantor nor grantee) and a named contingency. The grantor executes his deed, but instead of handing it to the grantee, it is handed to the person holding it in escrow. The third party frequently will be a bank or trust company.

When the escrow delivery has occurred, the title is, for the time being, in a state of suspense. The grantor has parted with his title by the act of delivery. The grantee has not yet obtained title and will not obtain until the happening of the contingency. Con-

sequently, during the period of escrow, neither grantor nor grantee can deal with the property. A title, if so held, will pass upon the happening of the named event. When this occurs, the third party delivers the deed to the grantee, completing the transfer.

In the transfer of title by means of delivery in escrow, attention should be given to the choice of the third party and to fixing the terms of final delivery to the grantee with certainty.

9. *Kinds of deeds*.—Forms of deeds in use have been determined in many states by statute. It will conduce to a clearer understanding of the choice of deeds if we divide them, as to form, into three main groups. These groups are:

- (a) Bargain and sale deeds
- (b) Warranty deeds
- (c) Quit claim deeds

10. *The bargain and sale deed*.—This is a short form of deed, in general use for the transfer of title when there are no warranties as to title by the grantor. The deed transfers whatever interest the grantor has in the property at the time of its execution. It is not sufficient to transfer any interest which he may later acquire. Consideration is essential, but the amount of it is unimportant, except in the conveyances of fiduciaries, and normally the consideration recited is "one dollar and other good and valuable considerations." A simple type of bargain and sale deed is illustrated by the following form:

(Individual)

The purposes of the clauses are fairly evident. The granting clause, recording the “grant and re-

lease" of the property to the party of the second part, contains the effective words of transfer. The *habendum* clause, which follows the granting clause, defines and limits the estate that is intended to be conveyed. If there is no recital of encumbrances, subject to which the title is being conveyed, the title is presumably free and clear. If there are encumbrances, such as mortgages, they may be stated following the description of the *habendum* clause, and restrictions on the use of the property may be inserted also following the description of the *habendum* clause.

The deed reproduced above is the form used by an individual. If a corporation is passing title, the statement of parties refers to the fact that the grantor is a corporation or body corporate of the state which has chartered it, and the final clause states that the corporation has "caused its corporate seal to be hereunto affixed and these presents to be signed by its duly authorized officers."

11. *Bargain and sale deed with covenant*.—In cases where title is transferred by a person who holds title as incident to an office or position of trust rather than in his own right, it would be inequitable to expect a warranty deed, but the grantee may rightfully expect that the titleholder will covenant that the property has not been encumbered by any act of his own. In these cases, the bargain and sale deed is enlarged by a covenant reporting, in substance, that the grantor "has not done nor suffered to be done"

any act affecting the title to the property, except as may be specifically set forth in the deed.

The bargain and sale deed, with covenant against the grantor's act, is used in the conveyances of trustees, administrators, executors, sheriffs, referees, and other persons who hold the formal, rather than the ultimate title to the property. Where title insurance is required, many persons prefer to give only a deed with covenants against grantor's acts, since the title company takes over the responsibility of warranting title.

12. *The quit claim deed.*—At common law, the quit claim was a secondary deed. It could be used only to transfer an interest in property to somebody who already had an interest in it. This is still the rule in some jurisdictions. The effective words are "re-mise, release, and forever quit claim." Like the bargain and sale deed, the quit claim operates to transfer any interest which the grantor has at the time of its delivery, but it contains no covenant as to title and it transfers no after-acquired interest.

13. *The warranty deed.*—The warranty deed adds, to the phraseology essential for passing title, the grantor's covenant as to the state of his title. These assurances as to the condition of title take the form of certain covenants, namely:

- (a) Assurance of *seisin*
- (b) Quiet enjoyment
- (c) Freedom from encumbrance
- (d) Further assurance
- (e) Warranty

The covenant that the grantor has seisin and right to convey means, in brief, that he represents himself as having the title and right to possession necessary to put the grantee into full enjoyment of the estate. If this covenant is broken at all, it is broken at the time the deed is delivered, for it relates to the grantor's status as of that time.

The covenant against encumbrances is the grantor's promise that the property is free and clear of all liens and encumbrances except those which have been specifically excepted elsewhere in the deed. This covenant, like the preceding one, is broken, if at all, at the time of delivery of the deed.

The covenant of further assurance is the grantor's promise that if, for any reason, further instruments are needed to perfect the grantee's title, he will execute them. This covenant may also impose upon the grantor the obligation of obtaining releases or quit claims from other parties, if the title is later assailed. It will be noted that the warranty deed, with this covenant, transfers not only the interest which the grantor has at the time of its delivery but also any interest which he may later acquire.

14. *Other covenants of warranty deeds.*—The covenant of quiet enjoyment is a representation that the grantee will not be disturbed in his possession of the property by any person claiming a title prior to that which has been conveyed. This covenant would be broken if the grantee should later be evicted from the premises, or disturbed in his possession of them,

by the assertion of a title or interest paramount to that of the grantor.

Finally, the covenant of warranty recites that the grantor will warrant, secure, and forever defend the title which he is conveying by the deed. By virtue of this covenant, the grantor may be "vouched in" to defend an action which may be brought assailing the grantee's title. If the grantor is not "vouched in," and there is a decision in some legal action adverse to the title of the grantee, this covenant affords the latter a right of action for damages which he has sustained.

It should be noted that the covenant of warranty refers to the title and not to the physical boundary of the premises. A deed, for instance, which describes a given property by metes and bounds and contains a covenant of warranty is not broken, even though the grantee may find that a structure on the property encroaches on a neighbor's lot, and is forced to expend money for removing it or to buy the lot from the neighbor. It is the title to the parcel of ground described which has been warranted. The condition, in this case, is one which should be brought to light by a survey before title passes, since the covenant of warranty affords no protection.

15. *Deeds for special uses.*—Occasionally, a deed will be given which contains vital errors, such as mistakes in description, which are not brought to light until some time after the delivery and recording. When these defects become known, it is customary to

obtain a new deed from the grantor. This will be similar in form to the original deed, correcting the errors and reciting that the deed is given for the purpose of correcting the error in the prior deed of record.

If a deed of this nature cannot be obtained from the grantor, a reformation of the original deed may be obtained, upon proper showing, from a court. States which view a mortgage as a conditional conveyance usually specify that the mortgagee give to the mortgagor a deed of release when the mortgage has been satisfied. A deed of release is also used to convey a remainderman's interest in real property to a life tenant, while, if the reverse situation occurs, the life tenant transfers his interest to the remainderman by a deed of surrender.

16. *Conveyancing in Canada*.—The Land Titles Acts in force in many of the provinces in Canada have simplified conveyancing. Land is transferred by means of a transfer reduced to the simplest form:

I, A. B. of the City of....., the registered owner of the freehold land registered in the office of Land Titles at.....as parcel.....in the register for....., in consideration of.....dollars paid to me, transfer to C. D. of the City of.....the land hereinafter particularly described, namely (description follows), being the whole (or part) of the said parcel.

A mortgage or charge is effected by equally simple language: "charge the land hereinafter particularly described, namely,———, with the payment to C.

D. of the principal sum of——dollars with interest," etc.; but, as is usual in a mortgage, complicated covenants and conditions follow. Where the Torrens or Land Title system is not in force, the common law rules apply and all the types of deeds are found in use.

Some types of statutory deeds may be noted here. Acts respecting short forms of conveyances and mortgages are to be found in the provinces of British Columbia, Manitoba, Nova Scotia, and Prince Edward Island. The short form wording in the prescribed form has a meaning which can only be understood by reference to the long form set out in the Act. A covenant, as, for example, "that the grantor has done no act to incumber the said lands," has a definite and extended meaning not appearing on the face of the deed. This extended meaning will not be given to the covenant unless the deed is expressly made in pursuance of the Short Form Act, in question. It is also important to avoid any change in the wording of the short form except by way of exception or qualification.

REVIEW

Define a deed. What is meant by execution?

Describe the method of making alterations in a deed.

Why must a deed be acknowledged?

State the effect of delivery of a deed.

List the kinds of deeds, and indicate the differentiating feature or features of each.

List and describe the covenants in a full covenant and warranty deed.

CHAPTER XI

LIENS

1. *A lien defined.*—It is important for the business man to know the rights of creditors as they affect real property. If real estate is to be purchased, the contract usually calls for a deed free and clear of all encumbrances, excepting those that are specifically mentioned and subject to which title is to be taken.

If real estate is sold, unsatisfied creditors have certain rights. To protect these rights, the statutes of many states prohibit fraudulent conveyances. The following is an extract from a typical statute:

Every gift, grant, conveyance, assignment, or transfer of, or charge upon any estate, real or personal, . . . made with intent to disturb, delay, hinder, or defraud creditors or other persons, . . . shall be void as against such creditors, purchasers, and other persons.

The law protects creditors by giving them the right to have a debt satisfied out of the property belonging to the debtor. This right is called a lien. The lien, if enforced by legal action, results in a court order authorizing the sale of the property to satisfy the debt. The method of procedure and the right of the lienor will depend upon whether the lien is general or specific.

A lien should not be considered as a conveyance, since it does not transfer title nor does it pass any estate to the lienor. Liens may come into existence by the action of law or by the voluntary act of the property owner. They may be either general or specific, depending on whether they attach to all of the property belonging to the creditor or to a particular piece.

A general lien is the right given under the law to proceed, in the satisfaction of a debt, against all property within a legal jurisdiction belonging to the debtor. Judgments are the most common general liens. Decrees, or the decision of a court in equity, decedent's debts, legacies, widow's allowances, transfer taxes, federal estate taxes, and corporate franchise taxes are also general liens.

2. *Judgments and decrees.*—A suit at law is terminated by the court's rendering a judgment for money damages. A court of equity renders a decree which may be for money damages or for some form of relief or for both. In either case, judgments and decrees are general liens against all property of the debtor in the court's jurisdiction. Judgments of an inferior court, with jurisdiction limited to a county, are not liens against land in other counties unless the judgment is also docketed there.

Any of the property, either real or personal, may be seized and sold to satisfy the lien. A judgment or decree cannot be defeated by a conveyance or transfer of a property, since that lien attaches to, and is

carried over with, the property, unless the lien is satisfied or unless the lienor agrees to sign a formal release.

Judgments and decrees are enforced by the court's directing the sheriff to seize any of the debtor's property and to offer enough of it for sale to satisfy the judgment, plus the expense of the sale and any other incidental expenses.

In Canada, as a general rule, a judgment does not become a specific lien upon the debtor's land until an "execution," based upon the judgment, is placed in the hands of the sheriff of the county or city in which the lands are situate. Where the Land Titles system is in force, the judgment or execution must be filed in the Land Titles office.

3. *Execution and removal of judgments.*—The statutes of some states provide that the writ to the sheriff empowering him to seize the property of the debtor must be obtained within one year after the judgment has been rendered, otherwise the judgment does not continue to be a lien. If execution is issued any time within a seven- or ten-year period after a judgment ceased to be a lien, it again takes its former status. The life of judgment and decree liens is regulated by statute. Their life normally is from ten to twenty years. The laws of some states provide that a judgment becomes a specific lien as soon as it is docketed in the county in which property is located and that it continues to be a lien for the statutory period.

The lien of judgments and decrees may be removed:

- (a) By paying the amount of the judgment with costs
- (b) By putting up bond and thus obtaining a satisfaction piece or suspension on appeal
- (c) By obtaining for consideration and filing a formal release or satisfaction piece
- (d) By the failure of the lienor to have an execution issued by the court
- (e) By the expiration of the statutory life of a lien.

4. *Liens against estates.*—The debts of a person deceased must be paid out of the estate of the deceased before the estate can be divided or disposed of. These debts are a general lien against all property belonging to the estate. The court may order the sale of as much property as is necessary for the settlement of these debts. If the personal property is insufficient to pay the debts, the lien on the real property becomes effective.

Money legacies, just as decedents' debts, may become a lien against real property, if there is not available enough cash or personal property to cover the amount of the legacy.

The widow's allowance, which is a pecuniary allowance granted by the statutes in some states, is a general lien against the property of the deceased, and may be satisfied out of the real property, if there is insufficient personal property. Such an allowance will continue to be a lien against the real property until satisfied.

The transfer, succession, or inheritance tax, as it is variously called, is levied by the state on the right of the heirs or distributees to receive, or in some states to transmit, the property of the deceased. The federal estate tax is levied upon the entire estate of the deceased. Both state and federal taxes are general liens against the estate and can be enforced by selling enough of the property to satisfy the tax.

5. *Corporate franchise taxes*.—Foreign as well as domestic corporations are taxed on their right to hold property and to carry on a business within the state. This usually takes the form of a tax on capital or capital stock. In some of the states, there is also a levy against net income.

This tax is a general lien against all assets of the corporation and can be enforced by proceeding against the real property, in case there is insufficient personal property to satisfy the debt. Usually, instead of proceeding against the property of the corporation, the state lifts the charter and thus dissolves the corporation, as a penalty for non-payment of taxes. If there are any assets remaining, the tax is collected out of the residue.

6. *Specific liens*.—Specific liens, as the name implies, are liens against particular or specific property. Mortgages, general property taxes, assessments, mechanic's liens, attachments, *lis pendens*, and vendor's liens are outstanding examples.

Since mortgages will be discussed more fully in a

later chapter, all that need be said about them here is that they are considered by the laws of most states as specific liens against real property. The other theory is that a mortgage is a conveyance of title from borrower to lender. The borrower remains in possession but does not retain title. The foreclosure proceedings in the states which hold to the theory that a mortgage conveys title are largely eviction proceedings and are, in many cases, tedious.

7. *Mechanic's liens*.—The right of a laborer, mechanic, or material man to receive payment for the services or material which he has furnished in the construction, repair, or alteration of a building is protected by special statutes, known as mechanic's lien laws. These laws specify the rights of the parties and provide a procedure for protecting those rights.

The mechanic's lien usually becomes effective by filing a notice in statutory form with the county clerk in the county in which the property is located or with the clerk of the circuit court. The law generally provides that the lien be filed within a certain time after the last material or service was furnished.

Some states provide that mechanics' liens shall take precedence in the order of their filing. Other states provide that the mechanics' liens shall all be on a par and shall be paid off proportionately, as between the lienors, instead of in order of filing. The lien usually continues for a statutory period, such as a year, and expires at the end of that period, unless renewed.

The mechanic's lien, like the mortgage, is enforced by legal foreclosure. It is usual for all of the lienors to join in the foreclosure action and thus settle their claims at once. This procedure is almost a necessity, since a lienor is allowed to sell only as much of his property as will satisfy his lien, and it might be very difficult or inadvisable to sell a large piece of property to settle a small claim, or it might be inadvisable to sell the property piecemeal, merely to satisfy the lienors in order. However, unless otherwise provided in the law, the claims will be settled in the order of their priority of filing.

Mechanics' liens terminate when they are paid off and a satisfaction piece is filed discharging the obligation, when their statutory life expires, when a bond is filed to cover the amount of the lien, or when sufficient money is deposited with the court to satisfy the claim. In some jurisdictions the lienor is required to establish his lien, by suit, within a stated period after filing.

In most of the provinces of Canada, the lien must be filed in the proper registry or land titles office against the specific land on which the lien is claimed. The lien will automatically expire, unless an action is commenced within the statutory period and a certificate of action filed in the same office. An action commenced by any lienholder will apply to the benefit of all lienholders whose liens were alive at that time; notice of the trial of the action must be given to all lienholders and all are entitled to prove their claims.

8. *Taxes and assessments.*—An entire chapter will be devoted to taxes and assessments, hence the discussion at this point will be limited to taxes as liens. Taxes are levied on both real and personal property on the assumption that the sovereign body has the right to collect from each citizen, according to his ability to pay, a share toward the expense of government. Taxes on due dates set by law become a specific lien against the property on which they have been levied. Assessments become liens when the amount of the assessment has been determined. If these liens are not paid, the property eventually can be sold, the lien satisfied, and the balance turned over to the property owner.

9. *Vendor's liens.*—The vendor has certain rights to or interests in property, both real and personal, which may be considered as liens although they may not be technically such. The conditional bill of sale and the land contract are examples of this type of quasi-lien.

Since title to land does not pass to the purchaser under a land contract, in many states, until the property is fully paid for, and since the purchaser has a certain right to, or interest in, the property because of having paid a part of the purchase price, such a contract, with the right to receive the balance of the purchase price, is in reality a vendor's lien against the property. The courts in many states require that vendors must foreclose such contracts the same as mortgages are foreclosed.

Generally, a vendor has a lien against a property for the unpaid balance of the purchase price, whether evidenced by contract, mortgage, or not. The purchase-money mortgage is really a written acknowledgment of the vendor's lien.

10. *Lis pendens*.—If the title to real property is involved in a suit, this pending action is called *lis pendens*. Such pending action is notice to those intending to purchase that the interest which the purchaser will receive is subservient to the rights of the parties to the action as finally determined at the completion of the proceedings. This is, in effect, a lien which can only be discharged by settling the pending litigation. In Canada, a certificate of *lis pendens* should be filed in the proper registry or land title office against the lands in question.

11. *Attachment liens*.—An attachment may be levied on the property of a non-resident debtor who cannot be reached by ordinary legal process. Statutes in each state govern the requirements and must be strictly followed. The attachment becomes a lien when levy has been made under the writ.

12. *Encumbrances*.—Certain encumbrances are very similar to liens. The violation of restrictions, governmental regulations, zoning regulations, etc. may result in a penalty, which also takes more or less the form of a lien. The whole subject of encumbrances will be taken up in the chapter on limitations upon ownership.

13. *Priority of liens*.—Liens normally take pre-

cedence in the order of their recording, except as the statutes or agreements between the parties may alter that order. A mortgage recorded at ten o'clock this morning takes precedence over one recorded at noon, even though the one at noon was given as a first mortgage. The lien of taxes is prior to any other lien, except those coming under the uniform bankruptcy act.

The rank of liens may be changed by agreement, as is the case when a mortgage is made subordinate to an existing mortgage. The effect of a subordinate agreement is discussed in Chapter XII. State statutes may alter the priority of liens by placing all liens of a certain class on a par, as is true of mechanics' liens in many states.

REVIEW

- Define a lien. Distinguish between specific and general liens.
- Explain how judgments and decrees may be removed.
- List and describe briefly the various kinds of general liens.
- List and describe the various kinds of specific liens.
- Discuss the priority of liens.

CHAPTER XII

NOTES, BONDS, AND MORTGAGES

1. *Most real estate is mortgaged.*—Most real estate held for business purposes is mortgaged. As we have seen, the average business reduces to a minimum its real estate investment, preferring to lease rather than to buy. When property must be purchased, it is not always bought outright but is mortgaged, thus enabling the business to use most of its surplus for expansion. As part of the security under the mortgage, the large industrial corporation usually pledges not only the land and structures, but also all equipment and machinery.

A lender advances money to a borrower to obtain a regular and secure income. He is interested both in physical security and in earning power. The former is important in case of default, but earning power, actual or prospective, is a vital consideration in the case of large loans, since the mortgage interest must come out of the property or out of the other income of the borrower. In the case of loans on residences or unimproved property, the borrower's personal finances, earning power, and credit should receive careful attention, in addition to that bestowed upon the value of the pledged property.

2. *Mortgage theories.*—There are two prevailing theories concerning mortgages. One views a mortgage as a conveyance of the property from the borrower to the lender. On this theory, the mortgagee is the titleholder of record and the foreclosure procedure is simply that of proving the debt unpaid and the right of the mortgagee, under the agreement, not only to the title but also to possession. The other theory is that the mortgage is a lien. The mortgagee secures payment of what is due him by obtaining a judgment and writ of execution, resulting in the sale of the property to satisfy the debt.

3. *Methods of mortgaging property.*—Mortgaging procedures vary according to the source of the loan that is sought. If it is being obtained from an individual lender, the borrower executes a bond, or notes, in addition to the mortgage. The bonds or notes are written promises to pay the debt with interest, and the mortgage pledges the real estate in payment. If the loan is obtained from a lending institution, the same procedure is usually followed. The loan may be split up into participations, whereupon the participation agreement becomes a part of the contract.

If the loan is obtained from the investing public by selling bonds, a third party enters the picture in the form of a trustee who is the legal mortgagee. In some states, the borrower must place a deed to the property in escrow with a trustee, together with notes drawn for the payment of both principal and

interest. The escrow agreement provides that the trustee shall turn over the deed to the lender when interest is defaulted for thirty days or the principal sixty days, thereby making the lender the titleholder of record. When the principal and interest have been paid, the trustee marks the notes accordingly, returns them to the borrower, and turns the money over to the lender. Finally, the unrecorded deed is returned to the borrower, which he destroys, and thus the whole mortgage operation is ended.

Most of the states which allow this method of mortgaging also give to the borrower the right of redemption, which may be for one, three, or five years. At any time during this period, the borrower has the right to pay off the notes, with interest, and recover the deed to his property from the lender.

4. *Trusted mortgages*.—A trusted mortgage is the preferred method of handling a large loan or one involving the offering of bonds to the investing public. A deed of trust is executed by the borrowing corporation to the trustee, covering his duties and responsibilities and describing the bond issue to be authenticated by him and secured by a mortgage. The trustee is made the legal mortgagee and charged with the duty of protecting the interests of the bondholders. If there is a breach of any covenant in the mortgage, the trustee takes legal action to safeguard the bondholder. If foreclosure is necessary, the bondholder does not institute the action but relies upon the trustee to do so. In some cases, a majority

of 75 per cent of the bondholders may agree to waive foreclosure. The trustee system of mortgaging property is widely used, because it gets around the difficulty of securing concerted legal action from a large group of bondholders.

5. *Kinds of mortgages.*—Of the several methods of classifying mortgages, perhaps the best is by character of lien. Mortgages by this method may be classed as first, second, third, fourth, etc.; as purchase-money, subordination, leasehold and collateral lien mortgages; as mortgage participations, junior or senior mortgage participations, or mortgage certifications; or as construction, permanent, serial, and sinking fund mortgages.

First, second, or third mortgages are, as the names indicate, a first, second, or third lien against the property which is pledged as security for the loan. The priority of liens is governed by the recording acts, which makes it necessary to record a lien in the proper recording office in order to give constructive notice to all persons of the existence of the lien. Liens then take priority in accordance with their chronological order of recording.

A purchase-money mortgage is one which has been given by the purchaser to the seller in lieu of cash as part payment for the property. It may be, but very seldom is, a first mortgage, since the property usually is sold subject to existing mortgages. Almost always it takes the rank of a second, third, or even a fourth mortgage.

The purchase-money mortgage can be used to advantage in buying and selling property. The difficult problem is to finance the equity. Often the purchaser has little ready cash to put into the property. If the seller is willing to take back a purchase-money mortgage for part of his equity in the property, a sale may be effected which otherwise would be impossible. If the seller wants to get his money out of the purchase-money mortgage, it may be discounted in the mortgage market.

Another advantage of the purchase-money mortgage, often overlooked, is the fact that the mortgage becomes a lien simultaneously with the passing of title. It stands superior to any and all prior claims against the property derived through the buyer, such as outstanding judgments, and the dower right of the buyer's spouse.

6. *Subordination mortgage*.—The subordination mortgage is one which is subordinated by agreement to a future mortgage. Ordinarily, when a first mortgage is paid off and satisfied, the second mortgage becomes a first mortgage. If the second mortgage is a small one, this results in an undesirable financial structure.

The subordination clause remedies this undesirable situation by providing that, if prior mortgages are paid off or are renewed, the subordinate mortgage shall remain a junior lien in the order of its original priority. The borrowing capacity of a \$50,000 property is hampered by the existence, say, of a \$10,000

mortgage, originally a second mortgage, but now a first mortgage because of the paying off of a prior one. Whereas the owner should be able to borrow \$25,000 on a first mortgage, he will now be compelled to use a first and a second to raise the same amount. Had a subordination clause been provided, this would not be necessary.

7. *Other types of mortgage.*—A leasehold mortgage is one that is secured by a leasehold and does not rest upon the land. The security in this case is the right to use and possess, without actually owning, but ownership is not essential from the standpoint of income.

A collateral lien mortgage is not necessarily a first lien against real estate. It is usually a first lien against collateral which may or may not be strictly first lien collateral. In some cases, the collateral is stock or bonds or it may be mortgages.

Mortgage participations are interests in a mortgage, which are evidenced by a participation agreement and represented usually by participation certificates. The participations may be equal as far as the lien is concerned or they may be junior and senior, if applied to first and second mortgages. Mortgage certificates are really collateral lien certificates. The collateral should be a first mortgage.

A building mortgage is secured by land and a building under construction at the time of executing the mortgage. A permanent mortgage is usually executed by the borrower when the building is com-

pleted. It takes the place of the construction mortgage or the latter may finally become the permanent mortgage.

A serial mortgage is one which is paid off in installments over its life and might better be called an installment mortgage. An installment mortgage, however, carries a proviso whereby the lender may call on the borrower to reduce the amount of the mortgage if the property should lose value, due to depreciation, obsolescence, or neglect.

The sinking-fund mortgage provides that each year a certain sum must be set aside to retire the mortgage at maturity. If provision is made in the sinking-fund agreement, the sinking fund may be used to reduce the mortgage during its life.

A "floating charge" is often used, in Canada, in connection with mortgages to secure bonds or debentures. It operates as a continuing charge on the property, but until it "fixes" or "crystallizes," the company may create specific mortgages ranking in priority to the floating charge. Unless otherwise agreed, a property retains its floating charge until a receiver is appointed or a winding up commences.

8. *The bond.*—The bond or note is the personal promise of the borrower to pay. The mortgage secures the loan by a lien on the real property pledged. Whether a bond or a note is used depends upon legal requirements in the state where the real property is situated.

The following form of bond is used in many states:

KNOW ALL MEN BY THESE PRESENTS

That hereinafter designated as the obligor, do.....hereby acknowledge to be indebted to.....hereinafter designated as the obligee, in the sum of.....dollars, lawful money of the United States, which sum.....said obligor do.....hereby covenant to pay to said obligee..... or assigns, on the.....day of..... 19..... at the rate of.....per centum per annum, and to be paid on the.....day of..... next ensuing the date hereof, and semiannually thereafter.

AND IT IS HEREBY EXPRESSLY AGREED THAT

the whole of said principal sum shall become due at the option of said obligee after default in the payment of interest for thirty days, or after default in the payment of any tax or assessment for thirty days after notice and demand. All of the covenants and agreements made by the the said obligor.....in the mortgage covering premises therein described and collateral hereto are hereby made part of this instrument.

Signed and sealed this.....day of.....19....

In the presence of.....

(Should be acknowledged if to be recorded)

An inspection of the above form shows the following to be the essential features of a bond:

- (a) Statement of parties
- (b) Acknowledgment of the debt
- (c) The promise to pay
- (d) Rate of interest
- (e) Time of payment of interest
- (f) The provisions for default
- (g) The execution

The bond must be witnessed; in some states, it also must be sealed. Since it is not ordinarily recorded, there is no necessity of acknowledgment, although this will be necessary to admit it to record.

If the bond is to be paid in installments, instead of in its entirety at maturity, a clause is inserted in the bond to that effect. If there is a provision in the bond giving the borrower the right to pay off more than the stated installment, the installment clause should provide for payments in anticipation of future installments.

In Canada, the bond, in the sense used above, is not employed as a separate instrument, apart from the mortgage, but every mortgage contains or implies a covenant to buy, and judgment can be obtained upon this covenant.

9. *Form of the mortgage.*—The mortgage is the instrument which pledges real estate as security for the payment of a loan. It takes very much the form of the deed, as can be seen by comparing the first part of a mortgage with a deed. The following is typical in many states:

MORTGAGE

THIS MORTGAGE, made the.....day of
.....nineteen hundred and.....
between
the mortgagor, ...
the mortgagee.

WITNESSETH, that to secure the payment of an indebtedness in the sum of.....

dollars, lawful money of the United States, to be paid on the day of nineteen hundred and, with interest thereon to be computed from....., at the rate of.....per centum per annum, and to be paid

according to a certain bond or obligation bearing even date herewith, the mortgages to the mortgagee,.....

And the Mortgagor covenants with the Mortgagee as follows:

1. That the mortgagor will pay the indebtedness as hereinbefore provided.

2. That the mortgagor will keep the buildings on the premises insured against loss by fire for the benefit of the mortgagee.

3. That no building on the premises shall be removed or demolished without the consent of the mortgagee.

4. That the whole of said principal sum shall become due after default in the payment of any installment of principal for days, or after default in the payment of interest for days, or after default in the payment of any tax, water rate or assessment for days, after notice and demand.

5. That the holder of this mortgage, in any action to foreclose it, shall be entitled to the appointment of a receiver.

6. That the mortgagor will pay all taxes, assessments or water rates, and in default thereof, the mortgagee may pay the same.

7. That the mortgagor within days upon request in person or within days upon request by mail will furnish a statement of the amount due on this mortgage.

8. That notice and demand or request may be in writing and may be served in person or by mail.

9. That the mortgagor warrants the title to the premises.

10. That in case of a sale, said premises, or so much thereof, as may be affected by this mortgage, may be sold in one parcel.

11. That the whole of the principal sum shall become due at the option of the mortgagee, after default for thirty days after notice and demand in the payment of any installment of any assessment for local improvement heretofore or hereafter laid which is or may become payable in annual installments, and which has affected, now affects, or hereafter may affect the said premises, notwithstanding that such installments be not due and payable at the time of such notice and demand; and also that the whole of said principal sum shall become due at the option of the mortgagee upon any default in keeping the buildings on the premises insured against loss by fire as required by paragraph numbered "2" above, or immediately upon the actual or threatened demolition or removal of any building erected or to be erected upon said premises, or if after application by any holder of this mortgage to two or more fire insurance companies lawfully doing business in the State of New York and issuing policies upon real property situate in the place where the mortgaged premises are situate, the companies to which such application has been made shall refuse to issue such policies.

12. In the event of the passage after the date of this mortgage of any law of the State of New York, deducting from the value of land for the purpose of taxation any lien thereon, or changing in any way the laws for the taxation of mortgages or debts secured by mortgage for State or local purposes, or the manner of the collection of any such taxes, so as to affect this mortgage, the holder of this mortgage and of the debt which it secures, shall have the right to give thirty days' written notice to the owner of the land requiring the payment of the mortgage debt. If such notice be given, the said debt shall become due, payable and collectible at the expiration of said thirty days.

13. That the holder of this mortgage, in any action to foreclose it, shall be entitled (without notice and without

regard to the adequacy of any security for the debt), to the appointment of a receiver of the rents and profits of said premises; and in the event of any default in paying said principal or interest, such rents and profits as hereby assigned to the holder of this mortgage as further security for the payment of said indebtedness.

14. If any action or proceeding be commenced (except an action to foreclose this mortgage or to collect the debt secured thereby), to which action or proceeding the holder of this mortgage is made a party, or in which it becomes necessary to defend or uphold the lien of this mortgage, all sums paid by the holder of this mortgage for the expense of any litigation to prosecute or defend the rights and lien created by this mortgage (including reasonable counsel fees), shall be paid by the mortgagor, together with interest thereon at the rate of six per cent per annum, and any such sum and the interest thereon shall be a lien on said premises, prior to any right, or title to, interest in or claim upon said premises attaching or accruing subsequent to the lien of this mortgage, and shall be deemed to be secured by this mortgage and by the bond which it secures. In any action or proceeding to foreclose this mortgage, or to recover or collect the debt secured thereby, the provisions of law respecting the recovery of costs, disbursements, and allowances shall prevail unaffected by this covenant.

IN WITNESS WHEREOF, this mortgage has been duly executed by the mortgagor.

In presence of:

STATE OF
County of

} ss.

On the day of, nineteen hundred and before me came to me known and known to me to be the individual... described in, and who executed, the

STATE OF } ss.
County of }

Analysis of a mortgage gives us the following list of essential parts:

- (a) Date
- (b) Statement of parties
- (c) Reference to the bond and the amount of debt
- (d) Default clause
- (e) Granting clause or pledge of property
- (f) Description of property
- (g) Habendum clause ("to have and to hold")
- (h) Defeasance clause ("provided always")
- (i) Mortgagor's covenants:
 - (1) Promise to pay
 - (2) Power to sell in case of default
 - (3) Insurance and demolition clause
 - (4) Default covenant
 - (5) Right to appoint receiver
 - (6) Right of mortgagee to pay taxes, etc.
 - (7) Brundage clause
 - (8) Written notice

- (9) Warranty of title
- (10) Statement of account due
- (11) Recovery of costs
- (j) Execution

10. *Supervision of the mortgage.*—Because the obligations of the mortgagor to keep the property repaired and insured and to pay the taxes are all designed to protect the security of his loan, the mortgagee should be alert to see that these requirements are observed. If these items have not been cared for, the mortgage is theoretically in default and the bond may be declared due and payable. In that event, the mortgagee can proceed to foreclose the mortgage. Such steps are not usually taken unless there is gross negligence on the part of the mortgagor. Many mortgages are in technical default at some time during their life, entailing the necessity of following up the mortgagor.

11. *Disposition of mortgage in case of a sale.*—How shall the mortgage be disposed of in the event the property is sold? Three methods of disposal are available. First, the seller may require the purchaser to obtain a new loan from the present mortgagee or from another lender, so that his name will be removed from the original bond and mortgage.

Second, the purchaser may take title, subject to the existing mortgage. The mortgagee still has the right to foreclose the mortgage, in case of default, and sell the property to satisfy the bond. If there is a deficiency, the original mortgagor is liable for

it, since the mortgagee still has his bond. The buyer is not personally responsible for the deficiency.

Third, the purchaser may assume the mortgage and make himself primarily responsible. If the property does not sell for enough to pay the bond, the purchaser can be held liable. In theory, he is the principal on the bond and the original obligor is the surety. Hence, the mortgagee can have recourse to the seller or to the original obligor, in case the property does not bring enough to satisfy the debt.

12. *Satisfaction of the mortgage.*—The mortgage is satisfied by the mortgagor paying to the mortgagee all that is due on the bond. The mortgagor should demand a satisfaction piece or other means of discharging the mortgage from record. The following is a form of satisfaction piece:

KNOW ALL MEN BY THESE PRESENTS, that I,.....
Do HEREBY CERTIFY, that a certain indenture of mortgage,
bearing date the.....day of.....nineteen
hundred and....., made and executed by.....
to secure payment of the principal sum of.....,
dollars and interest, and duly recorded in the office of the
.....of the County of.....in liber
.....of mortgages, of section.....page.....,
on the.....day of.....nineteen hundred
and.....

.....(L. S.)

In the presence of

.....

(Acknowledgment)

In some states, a satisfaction piece is not used to discharge a mortgage from record. Instead, the

mortgagee writes on the face of the instrument an authorization to discharge in substantially the form following:

This indenture having been satisfied this.....day of 193 , the county clerk (Register of Deeds) of the County of.....is hereby authorized to cancel and discharge the same of record.

(Signed)

The return of the bond is important and should be insisted upon by the borrower.

In Canada, various forms of discharge are in use, depending on the requirements of the Registry Act, under which the mortgage is registered. Usually, a certificate of discharge is required, identifying the mortgage by date and number. Upon registration, it operates as a re-conveyance of the property to the mortgagor. The term "cessation of charge" is used in Ontario in connection with mortgages or charges registered under the Land Titles Act of Ontario.

13. *Foreclosures*.—If the mortgage is not paid when due, or, if default is made on any of the covenants, the mortgagee may commence foreclosure proceedings. Foreclosure normally involves reference of the case to a master in chancery or referee, to determine the amount due. There then follows a judgment of the court in favor of the mortgagee and a decree of foreclosure, enforced by an order to the sheriff for the sale of the property at public auction, after properly advertising the same. If the sale yields more than enough to settle the mortgage

and court costs, the balance is turned over to the mortgagor. If less than enough is realized, a deficiency judgment is rendered in favor of the mortgagee. This may be enforced by docketing the judgment in the county in which the mortgagor holds property.

In Canada, the term "foreclosure" is usually applied to the right of the mortgagee to foreclose or extinguish the mortgagor's equity of redemption, that is, his right to redeem or pay off the mortgage. The right must be exercised by an action in the courts and a definite period, usually six months, is given the mortgagor to pay the amount found due. If he fails to pay, a final order of foreclosure is made and the mortgagee becomes the absolute owner of the property. The mortgagor may, on certain terms, require the property to be put up for sale.

The mortgagee's right to foreclose is quite distinct from the power of sale given him by his mortgage. This is a right that may be exercised, without the intervention of the courts, upon notice to the mortgagor in the manner prescribed in the mortgage.

14. *Usury*.—All states have laws designed to protect the borrower against the charging of excessive interest rates by lenders. A legal rate of interest is usually established and any rate above that is usurious, involving various penalties to the lender. Other states designate a rate which shall apply when the rate is omitted in an instrument, but allow a legal contractual rate up to 10 or 12 per cent. It must

be remembered that corporations are prohibited by law from setting up the defense of usury.

Frequently, in a time of high money rates, bonuses and expenses are demanded by mortgagees, which really have the effect of making the interest rate usurious. In such cases, lenders are able to avoid the charge of usury by calling the bonus an investigation fee. Although a high rate may be usurious in the technical sense of the word, there may not be evidence of usury or extortion. Courts are prone to recognize the fact that lenders take certain risks for which they should be compensated. As long as there is no evidence that the lender has taken undue advantage of the borrower's need for funds, the defense of usury will not be recognized.

In Canada, the Dominion Parliament has exclusive jurisdiction over the subject of interest. The Interest Act does not limit the rate of interest that may be charged on mortgages, but some important provisions should be noted here. Where any principal money or interest is made payable on the sinking fund plan, or on any plan under which the payment of principal and interest is blended, no interest whatever shall be chargeable, unless the mortgage contains a statement showing the amount of such principal money and the rate of interest chargeable thereon calculated yearly or half yearly, not payable in advance.

As a result of recent decisions in Ontario, based upon this Act, it is necessary to regard a bonus as

interest, and, if the correct rate of interest is not set out, no interest whatever may be recovered. If, for example, the mortgage was for \$800, with interest at eight per cent, but the actual amount advanced was \$750, the \$50 being retained as a bonus, the mortgagee could recover no more than \$750, without any interest, unless the true rate of interest were set out in the mortgage, taking into account both the bonus and the stipulated interest. It has also been held that a mortgagor has an absolute right to recover a bonus paid in contravention of the Act, even after the mortgage has been paid off.

REVIEW

Why is most real estate mortgaged? Describe the various methods of mortgaging property.

Define a bond. List the essential features of a bond.

List and explain the essential parts of a mortgage.

Name and describe the three methods of disposing of mortgages in case of a sale.

Describe the foreclosure procedure.

Define, briefly, trustee mortgage, satisfaction piece, usury.

CHAPTER XIII

LEASES

1. *Terms defined.*—A lease is an instrument transferring the right to enjoy, possess, use, and control property for a definite term at a fixed rental, with certain specified limitations. The lease may be verbal or written. In some states, the statute of frauds provides that a lease for one year or more must be in writing. In other states, the lease may be verbal, if not for more than three years. The owner of the property is the lessor or landlord, the user the lessee or tenant, the payments for the use of the property are rent, and the time of the letting is called the term. If a tenant subleases, he becomes a sublessor, and his tenant, a sublessee.

2. *Kinds of leases.*—Leases may be classified according to their most important or unusual features, although in fundamentals they are the same. Essentially, they are all contracts for the letting of property.

From the standpoint of duration, leases are designated as either short or long term. In some sections of the country, leases frequently run for ninety-nine, nine hundred and ninety-nine, or one thousand years, or they may even be perpetual. In other sec-

tions, the longest lease executed is for ninety-nine years. Normally, however, a lease for ten years or less would be considered a short-term lease and anything over ten years a long-term lease. In states where leases for twenty-one years or longer are taxed as real property, such leases are classified as long term.

Leases are made for either a fixed or a variable rental. In the latter type, the rental is a share of the crop or some other return from the property. An arrangement may also be made whereby a minimum fixed rental is paid and, in addition, a share of profits or sales, making the amount of the rent vary therewith.

Leases may involve month-to-month tenancy, that is, a letting for one month only, which continues as long as the tenant remains in possession and at the landlord's pleasure. The monthly tenancy, in contrast to the month-to-month tenancy, is indefinite as to the term of letting and merely stipulates a monthly rental. From a practical standpoint, both are uncertain as to their ultimate life. A lease from year to year is the same in principle as a lease from month to month.

The most common lease is for a stated term of years, whether for few or many. In some states, because of the rule against perpetuities, the law frowns on leases for longer than ninety-nine years, while, in others, there is practically no limit to the length. In some states, it is customary to designate twenty-one

years for a long-term lease, with the option of renewal under certain conditions.

3. *Leases according to form of rental.*—Variations in the method of paying rent give us another basis for classifying leases. The first to be discussed is the flat or straight lease. This kind calls for a stipulated annual or monthly rental, which does not change during the life of the lease. No allowance is made for an increased return to the landlord in case the property appreciates in value or is more heavily taxed. Some long-term leases provide that the tenant shall bear a proportional share of any increase in taxes.

The graduated lease provides for dividing the term of the lease into a number of periods and increasing the rental for each period until, by the end of the term, a maximum rental is reached. For example, a retail store may be leased for ten years, with the stipulation that the rental for the first three years shall be \$250 per month, for the next three years \$350, and for the remaining four years \$400. There may be a further provision for renewing the lease, at the option of the tenant, for a new term of ten years, at \$500. A long-term lease may be executed on a similar basis. One that was recently made provided that the rent on a ninety-nine-year lease shall increase, on a sliding scale, from \$60,000 to \$100,000 per year over the life of the lease.

A similar type is the percentage lease, which may better be called a participating lease, since under it

the payment of rental involves sharing in the earnings of the business. To illustrate, a recent lease in Chicago provided that the net rental was to be \$125,000 for the first five years, \$150,000 for the next five years, and \$175,000 for the remaining eighty-three years of the lease. It further provided that the landlord was to receive, as additional rent, one-half of the net earnings of the business, in excess of \$100,000, after taking care of all maintenance and operating costs, taxes, insurance, bond interest, bond payments, federal taxes, and ground rent, plus a flat amount of \$75,000 for the first five years, and \$100,000 for the remainder of the term.

4. *The reappraisal lease.*—The reappraisal lease attempts to provide a fair method of compensating the landlord for the increased value of his property, recognizing that he is entitled to a fair return on his investment. It provides that the property be reappraised periodically and that the annual rental for the next period be set at an agreed percentage of the fair appraised value.

Such a lease may take the form of a twenty-one year lease with two or more renewals for twenty-one years on an agreed reappraisal basis. The lease may also stipulate that appraisers shall be chosen by the landlord and tenant, and a third by the two designated appraisers, if their appraisals do not agree. This type of lease is fair both to the landlord and to the tenant, and in most instances is fairer than a graduated lease, although it does not allow increases

of value to accrue to the tenant except over a short period.

5. *Other kinds of tenancies.*—A tenancy-at-will allows both parties to terminate the lease at any time. The lessor must, of course, give the lessee a reasonable time in which to remove his property. Usually the death of either party will terminate the lease. Many leases, also, have a clause providing that under certain conditions the lease may be canceled. The landlord, for example, may intend to build on the plot, but does not know just when; for this reason he reserves the right to cancel the lease at any time on reasonable notice.

Certain leases are called ground-rent leases. For the most part, they are leases for a long term on vacant land or on land which is not adequately improved. They usually provide that the tenant shall build a suitable building on the property, the building in most cases being described in the lease. Such leases are for a long term to enable the tenant to get as much out of the building as possible before it reverts to the landlord at the termination of the lease. The building may revert to the landlord without payment of his part to the tenant, or appraisers chosen independently by the landlord and tenant may set the sum which the landlord shall pay. Either the landlord or the tenant may also have an option to buy at a certain price at any time during the life of the lease.

A net rental lease provides that the landlord shall

receive the net amount after such expenses as taxes, insurance, and repairs have been paid. This form of lease is usually demanded by an estate or individual who wants to be assured of a fixed income, from which there will be no deductions for maintenance expenses or carrying charges.

6. *Unusual and curious leases.*—Perpetual leases are not uncommon in some states. An example is the land on which the Glenn building stands, at the southeast corner of Fifth and Race Streets, in Cincinnati.

One of the most interesting leases is the famous "Sable Iron" lease in Boston. This lease was made between two brothers-in-law, in 1817, for 1,000 years, with the stipulation that the rental was to be paid in "Russian Sable Iron." Another Boston lease provides for the payment of rental in hay and grain. To date, this form of payment has been tendered regularly.

The site of the Red Rose church at Maheim, Pa., was leased to the congregation in 1772 with a stipulated rental, which was to be paid each June, of one red rose and five English shillings from each member of the congregation. This rental was to be paid to the descendants of William Spiegel. This is but another example of the curious and freakish leases that are occasionally executed.

7. *Holdovers.*—A holdover is a tenant who continues to possess property after the lease has expired, or after notice has been given to vacate, and a rea-

sonable time has elapsed. A holdover can be forcibly moved out or can be held for a renewal of the lease, usually for one year. A tenant who has held over, failed to pay rent, or broken any covenant of the lease, may be legally ejected by a dispossession proceeding. This action is brought in courts of justices of the peace or in municipal courts. The petition states the conditions of the lease and the cause for action, and prays the court for a warrant of dispossession. If the tenant does not answer the notice, the court gives judgment in favor of the landlord, issues the warrant of dispossession, and the sheriff proceeds forcibly to remove the tenant.

In Canada, the term usually applied to such a tenant is "overholding tenant." In most provinces, an overholding tenant may be ejected by summary proceedings before a county court judge. There is, however, no procedure to compel a renewal. In some provinces, there is a provision for obtaining double rent.

8. *Assignment and subletting.*—Many leases specify that the tenant shall not sublet a part or all of the premises without the consent of the landlord. If this consent is obtained, the following form of assignment of lease is executed:

ASSIGNMENT OF LEASE

Know that Assignor, in consideration of dollars paid by assignee, hereby assigns unto the assignee, a certain lease made by, to, dated the

day of, and recorded on the
 day of, in the office of the of
 the country of in liber..... of convey-
 ances at page covering premises
 together with the premises therein described, and the build-
 ing or buildings thereon, with the appurtenances.

To have and to hold the same unto the assignee, ...
 and assigns, from the day of
 nineteen hundred and, for all the rest of
 years mentioned in the said lease, subject to
 the rents, covenants, conditions, and provisos therein also
 mentioned.

And the assignor hereby covenants that the said assigned
 premises are free from incumbrances.

In witness whereof, the assignor has hereunto set his
 hand and seal this day of,
 nineteen hundred and

In presence of:

.....
 Signature

The subletting of property is very similar to the
 process of assigning a lease, except that the tenant
 is releasing only a part of the premises, instead of
 all. There usually is a clause which prohibits the
 subletting of property, except with the consent of
 the landlord.

Nearly every Canadian lease contains a provision
 that the tenant cannot assign or sublet without leave;
 but by statute, in many provinces, such leave may
 not be unreasonably withheld, and in Ontario, if the
 landlord refuses to give leave, the tenant may apply
 to court to determine whether or not the consent is
 unreasonably withheld.

9. *Notice to renew lease.*—If the tenant desires to renew the lease, he must give the landlord notice of his intention. This may be oral, but preferably should be in writing. Notice may be given informally by letter or formally on a special blank. Such notice is usually given at a reasonable time before the lease expires, or the lease itself may provide that notice to renew must be given so many days or so many months before its expiration.

10. *Methods of termination.*—The most common methods of terminating a lease are by expiration of the term and by a breach of one or more of the covenants of the lease, such as non-payment of rent. A lease may also be terminated by mutual consent, known as surrender and acceptance or by constructive eviction.

Constructive eviction occurs when the property is in such condition that it is impossible for the tenant to remain in possession or use of the property. To be an effective defense for breaking a lease, the tenant must move out while the property is in the uninhabitable condition.

A state or city may exercise its right of eminent domain and seize a property after due process of law and after paying its fair value. The tenant must move elsewhere and this terminates the lease. If the lease is a valuable one to the tenant, he is entitled to some compensation for his right to use the property under the terms of the lease, and many times the

sovereign body is forced to pay something for the value of that right.

11. *Form of the lease.*—There is no uniform type of lease. Very few states have even designated a statutory form. Some brokers and property managers have drawn up very usable forms and something has been done by the local real estate boards or building owners' and managers' associations to standardize the lease.

The essentials of a lease are competent parties, a description of the property, the date, term, and rental, together with covenants to protect both the landlord and the tenant. The following is a typical short-form lease:

LEASE

THIS INDENTURE, made the day of one thousand nine hundred and thirty

Between of the second part Witnesseth, that the said part of the first part ha letten and by these presents do grant, demise, and to farm let, unto the said part of the second part, and the said part of the second part ha hired and taken and by these presents do hire and take of and from the part of the first part, (description) with the appurtenances, for the term of from the day of one thousand nine hundred and thirty at the yearly rent or sum of to be paid in equal payments, ...

And it is agreed that if any rent shall be due and unpaid, or if default shall be made in any of the covenants herein

contained, then it shall be lawful for the said part of the first part to re-enter the said premises and the same to have again, to re-possess and to enjoy.

And the said part of the second part do covenant to pay unto the said part of the first part the yearly rent as herein specified.

And that at the expiration of the said term the said part of the second part will quit and surrender the premises hereby demised, in as good state and condition as reasonable use and wear thereof will permit, damages by the elements expected.

And the said part of the second part do hereby expressly covenant and agree, that if the said demised premises shall become vacant at any time during the said term, the said part of the first part and . . . legal representatives or assigns may re-enter the same by force or otherwise without being liable to any prosecution therefor, and may re-let the said premises as the agent for account of the said part of the second part, and receive the rent thereof, applying the same first to the payment of such expenses as . . . may be put to in re-entering and re-letting, and then to the payment of the rent due by these presents, with interest, and the balance, if any, to be paid over to the said part of the second part, and any deficiency which may arise, the said part of the second part hereby covenant to pay in full.

And the said part of the first part do covenant that the said part of the second part, on paying the said yearly rent, and performing the covenants aforesaid, shall and may peaceably and quietly have, hold and enjoy the said demised premises for the term aforesaid.

In Consideration of the letting of the premises within mentioned to the within named and the sum of one dollar to me paid by the said part of the first part do hereby covenant and agree, to and with the part of the first part above named, and legal representatives, that if default shall at any time be made

by the said in the payment of the rent and performance of the covenants contained in the within lease on part to be paid and performed, that will well and truly pay the said rent, or any arrears thereof that may remain due unto the said paid part of the first part, and also all damages that may arise in consequence of the non-performance of said covenants, or either of them, without requiring notice of any such default from the said part of the first part.

Witness hand and seal this day of in the year one thousand nine hundred and

Witness

.....

State of

..... of

County of

On the day of in the year one thousand nine hundred and before me personally came to me known and known to me to be the individual described in, and who executed the foregoing instrument, and acknowledged to me that he executed the same.

Some landlords prefer a long form even for a short-term lease. The main difference is that the long form contains covenants which apply to particular types of property.

12. *Short-form leases in Canada.*—In some of the provinces of Canada, acts have been passed known as the Short Forms of Leases Acts. In these provinces, a short-form lease means a lease made in pursuance of the Act, and it should be carefully noted that the covenants contained in the lease have a definite and extended meaning which can only be understood by

examining the schedule in the Act setting out the extended terms.

To illustrate, the fire clause in the Ontario short-form lease reads: "Provided that in the event of fire, lightning or tempest, rent shall cease until the premises are rebuilt." By statute, these words are extended to read:

Provided, and it is hereby expressly agreed, that in case the premises hereby demised or any part thereof shall, at any time during the said term, be burned down or damaged by fire, lightning or tempest, so as to render the same unfit for the purposes of the said lessee, then and so often as the same shall happen, the rent hereby reserved, or a proportionate part thereof, according to the nature and extent of the injuries sustained, shall abate, and all or any remedies for recovery of the said rent or such proportionate part thereof shall be suspended until the said premises shall have been rebuilt or made fit for the purposes of the said lessee.

13. *Covenants in a long-term lease.*—The opening clauses of a long-term lease are similar to those in a short-term lease, but the former is more complete and contains more covenants. Besides granting the property for a certain period at a certain rental, it covers such matters as existing party walls, the making of improvements, the privilege of paying rental in installments, place of payment of rent, interest on overdue rent, payment of taxes, apportionment of assessments, the use of the premises, the making of alterations, option to purchase, erection of new building, removal of building, deposit to secure landlord in case building is removed, covenant to remove me-

chanic's liens, covenant to carry fire and workmen's compensation insurance, restoration in case of fire, award if property is condemned, and surrender at expiration of terms.

REVIEW

Define the following: lease, lessor, landlord, lessee, tenant, rent, term, sublessee, sublessor, sublease, appraisal lease, hold-over.

Distinguish between a month-to-month and a monthly tenancy.

Describe the various methods of paying rent.

Describe the methods of disposing of leases. How may a lease be terminated?

What are the chief divisions of a long-term lease?

CHAPTER XIV

LIMITATIONS UPON OWNERSHIP

1. *Ownership not absolute.*—Since all estates are subject to certain limitations which cut down or circumscribe the rights of owners, there is no absolute ownership of real estate.

Laws against perpetuities and future vesting, statutes of descent, the rights of governing bodies, the rights of creditors, and the rights of contracting parties all limit, to some extent, the right to receive, to use, or to dispose of real estate.

In order to understand thoroughly the nature of these limitations, a glance at the history of land ownership and of the sources of title will be helpful.

2. *Development of land ownership.*—Under mediæval feudalism, which as a system has not been in effect for centuries, ownership of the land was vested in the king alone, although actually it was held and used "in fee" by a series of overlords, lords, and tenant-farmers. Gradually, the tenant acquired a limited right to dispose of the holding, providing always that he kept a residue sufficient for raising what was due to the lord of the fee. This provision is found in Magna Charta (1217). At this time, also,

or a little later, the dower right of a wife came to be recognized.

Step by step, the feudal theory of land ownership has been broken down, broader and broader rights have been given to the tenants, until now tenants can sell their lands and give a clear title without regard to the crown. Property passes to the heirs-at-law of a deceased tenant, free of restriction.

The series of reforms developed in England and incorporated in the common law were transplanted to America. Subsequent advances have been in the direction of restoring the simplicity of the common law and of discarding the remnants of feudal rules.

3. *Sources of title in the United States.*—It is interesting to note how the federal government and the various states acquired title to property. Great Britain's ownership of the land occupied by the thirteen original colonies was given up in the treaty of Paris, as a result of the American Revolution. Title to all lands east of the Mississippi, except Florida, not previously granted by the Crown to individuals, automatically passed to the states and ultimately to the federal government. The so-called Northwest Territory was a part of this acquisition. Then followed the Land Ordinance of 1784 and, more particularly, the Northwest Ordinance of 1787, providing for the admission of new states after they had first existed as territories. This ordinance served as the basis for a grant of federal lands to the states not included in the original thirteen.

The Louisiana purchase, in 1803, was the next extensive acquisition. Then followed the purchase of Florida from Spain, in 1819, and the purchase from England, in 1846, of the land now comprising Washington, Idaho, and Oregon. In 1848, the land now included in New Mexico, Arizona, Nevada, and Utah was annexed. Texas was annexed in 1845 and in 1867 Alaska was purchased from Russia. The islands of Porto Rico, Hawaii, and the Philippines were annexed in 1898.

Both federal government and states have made grants to individuals to encourage railroad building and agricultural development. The Homestead Acts and various state statutes have encouraged the settling of the western lands.

Thus, it is evident that the original sources of title, with few exceptions, can be traced back to the British Crown, the United States government, or to the various state governments. Lands were acquired by conquest, treaty, purchase, or annexation.

4. *Rights exercised by federal and state governments.*—The federal government levies an estate tax on the right to receive property by will or descent. In certain instances, it also limits the use to which property can be put. In addition, it holds jurisdiction over navigable waters and reserves the right to take property needed for public defense.

The state governments regulate, through the statutes of descent, the passing of property. They exercise the right of eminent domain, escheat, taxation,

and police power. They also prohibit restraints upon alienation.

The local governments have taken over such powers as have been expressly stated in the charters creating such minor political subdivisions. These powers usually include eminent domain, tax and police power.

In Canada, the legislative jurisdictions of the Dominion and of the provinces are clearly marked out. "Property and civil rights" within a province are exclusively within the jurisdiction of that province. Land is within the jurisdiction of the province in which it is situate; and the provincial legislature may deal with property in any way it sees fit, even to the extent of destroying private rights, without compensation. With regard to taxation, however, the Dominion parliament's power to raise revenue is unlimited, but the provincial legislatures are confined to direct taxation within the province for provincial purposes.

5. *Eminent domain*.—Eminent domain may be loosely defined as the right of the state to recover property held by any individual or corporation, provided the same is needed for a public purpose, and provided, further, that a reasonable compensation is paid for the property. The first step in acquiring a piece of property by the method of eminent domain is to negotiate with the owners for the purchase of the land at a fair price, as set by a court of equity. If negotiation fails to satisfy the owner, condemnation proceedings are next in order.

6. *Escheat*.—Escheat may be looked upon as one of the feudal remains still present in the laws affecting real estate, based as it is on the idea of the sovereign state's original and ultimate ownership of all property within its jurisdiction. This idea is combined with the further idea that ownership must at all times inhere in some individual or corporation, and never be left hanging, so to speak, in the air. It follows that the ownership of all property to which there is no apparent heir reverts to the state. This is the rule in most of the states, so that when a person dies, leaving no will, and having no ascendants or descendants to whom his property may pass by operation of law, it becomes the property of the state in which it is located.

It is interesting to note, at this point, that in many of our states a widow is not considered a proper party to receive ownership, prior to the right of escheat of the state. New York, considered to be a leader in progressive legislation, until recently permitted the state to take property by escheat in preference to a man's widow. The title thus vested in the estate could be redeemed to the widow only by long, drawn-out legal proceedings and, in many cases, by a commensurate fee for title to the property.

7. *Statutes of descent*.—The states have enacted statutes of descent to regulate the passing of title to the property of deceased persons. Normally, the property passes to the heirs, but the law gives certain rights to the surviving spouse. In most cases, it

also limits the amount of the estate which can be given away. The law also makes the decedent's debts a first lien against the estate.

The common rule against perpetuities makes void any granting of a fee estate with the condition that the grantee shall not alienate the land. A perpetuity, as defined by the United States Supreme Court, "is a limitation of property which renders it inalienable beyond the period allowed by law." The period allowed by law is usually measured by the lifetime of one or more living persons, plus a stated statutory period.

8. *Taxation and police power.*—The various governing bodies have reserved the right to tax property for the support of government or for the purpose of making public improvements. This right of taxation is an old feudal right carried over into the modern law affecting real property. It is in the truest sense of the word a limitation upon ownership in that the property-owner does not hold title free and clear from obligation to the state from which the title came.

The police power is the right of the governing body to protect the health, life, and morals of its citizens. One means of furthering these ends is regulating the use to which property can be put and its care in use. The tenement house, the multiple-dwellings, and emergency rent laws, and the regulations of the board of health, building department, fire department, and zoning commission are examples of state and municipal exercise of the police power for the purpose

of protecting citizens. They are genuine limitations upon the use of property, since the owner cannot follow his own will in building, but must conform to the various regulations of city and state.

9. *Municipal regulation of buildings.*—The cities and smaller political units have taken up the more strict enforcement of police powers. While the tenement house or multiple-dwellings laws are of state origin, covering types of buildings, permissible fire protection, and sanitation, the cities usually enact ordinances and establish departments to regulate these matters within their limits.

The fire department inspects buildings to see that fire traps are eliminated and inflammable materials properly protected against carelessness. The building department goes over plans for new buildings and alterations to see that they are in keeping with safety. The health and water-supply departments regulate matters which logically come under their jurisdiction.

10. *Zoning regulations.*—The owner may have a clear title, in that no encumbrances exist against the fee, but these same properties may become absolutely unfit for the uses desired, as the result of zoning regulations. The zoning laws of New York City will illustrate the type and form in general use.

The city is divided into four classes of district, according to the use to which buildings are to be put, namely, residential, business, retail, and unrestricted. Only that type of building proper to the district can be erected therein.

Buildings permitted in residential districts include dwellings and boarding houses, clubs (except those whose chief service is a business), churches, schools, libraries, public museums, court houses, fire houses, police stations, hospitals, and sanitariums.

In a business district, it is understood that the premises shall not be used for any kind of manufacturing or for any trade or industry which would be, in any way, offensive by reason of odor, dust, noise, etc.

A location may sometimes be on the borderline between a business and a residential district. One case of interest is that of a man who wanted to carry on a business on B Street, which was in a residential section. He found it possible to change the entrance from B to A Street, which was zoned for business purposes. Many other cases similar to this may be found.

The unrestricted district is one for which no regulations or restrictions of any kind have been handed down by the Board of Estimate and Apportionment, and which consequently, until zoned, can be used for any purpose whatever.

11. *Zoning for height.*—With reference to the height of buildings, New York City is divided into eight classes of districts, within which buildings may be erected to heights that are multiples of the width of the street, namely, one-quarter, one-half, three-quarter, one, one and one-quarter, one and one-half, two, and two and one-half times districts. To illus-

trate, let us assume that we are located in a one and one-half times district on a sixty-foot street. We shall be permitted to erect a building ninety feet high. That is not all, however, as we may also utilize the set-back rule, whereby for every foot of set-back, the height can be increased three feet, so that a ten-foot set-back will allow thirty feet of additional height. In the two times districts four feet can be added for each foot of set-back, and in a two and one-half times district, five feet can be added.

In the "area districts" we are confronted with a restriction for the purpose of regulating the area of yards, courts, and other open spaces for buildings. Six classes of area districts are provided for in New York, establishing the minimum size of such spaces in relation to the height of the inclosing walls. The size of recreational spaces for the use of apartment-house residents is also prescribed. In an F district, for example, no portion of any building shall be erected nearer than fifteen feet to the building line of any street.

These zoning laws are subject to the review of the Board of Appeals, which has the right, under proper circumstances, to modify the restrictions.

12. *Other restrictions.*—Government restrictions against nuisances forbid the use of a property for certain kinds of trades or business, such as boiler-making, bone-boiling, or the manufacture of ink or vitriol. Private restrictions may further limit the use of property. For example, it is quite customary

for a builder, in developing a piece of property, to put certain restrictions on it with reference to the type of buildings and improvements, as well as certain set-back regulations.

Restrictions on building at times prevent the property from being used for its best purpose, although the original idea behind them is to protect the property. Restrictions run with the land and, except in a very few cases, can only be discontinued by the consent of a majority of the property owners or by supreme court action. Such action will set aside the nuisance restriction on the ground that the caliber of the neighborhood has so changed that the restriction no longer is necessary.

If these restrictions are not set forth in full in real estate contracts, the purchaser has the right to reject title. The courts have held that, unless they are set out in the contract, the omission of restrictions permits of rejection on the ground of unmarketability of titles, and that a suit for the return of the deposit is also permissible.

Some of the provinces of Canada have passed acts which enable an owner to apply to court to modify or discharge building restrictions. Notice is given to all persons who appear to the judge to be interested, and the judge may take such an order as appears to be in the interest of all parties. But these acts do not apply to building restrictions imposed by any by-law passed, under proper authority, by any municipality.

13. *Liens and contracts.*—Liens should be con-

sidered as limitations upon ownership, since the foreclosure of a lien may result in the forced sale of a debtor's property. The creditor, whether an individual, a corporation, or a government, has the right to satisfy a debt out of the property belonging to the debtor. This principle applies to all types of liens: judgments, taxes, attachments, mechanic's liens, and inheritance taxes.

Other limitations arise from the purchase and sale of property which are discussed in Chapter XI on Liens. The installment sale contract sets up a particularly involved set of restrictions on the use and disposal of real estate.

14. *Easements*.—An easement originally described a class of rights enjoyed by certain persons, but today it is commonly used to denote the right or privilege which one person has to use and enjoy the property belonging to another. A common example is the driveway easement, whereby adjoining property-owners give a part of their property in order that access may be had to and from the garages erected in the rear. Party walls, easements for light and air, etc., are also common.

Easements may be created by adverse users, but this is not advisable. They are more commonly created by deed or by a special agreement, commonly called a declaration of easement. Once formed, easements run with the land and pass from the seller to the purchaser in the event of a resale of the premises.

Easements differ from licenses in being irrevocable.

If a property-owner gives a friend permission to use his grounds for fishing, it is purely a license, and upon due notice the privilege can be ended. A driveway easement, on the other hand, can be terminated only by the consent of the present owners in the interest.

An easement often arises by necessity. This right comes from an old principle of law which dictates that everyone shall have free ingress to, or egress from, his or her property. It may therefore become necessary to use someone else's land to reach one's own property. It must be remembered, however, that if any other means can be used, regardless of its inconvenience, an easement by necessity will not arise. An example of this can be found in an old Court of Appeals decision on the complaint of a person who, in order to reach a town, had either to cross the property of his neighbor or to go by a roundabout route in a boat. It was held, in this case, that there being access to the property, however inconvenient, there was no easement by necessity.

REVIEW

Explain why ownership of real property is not absolute.

Trace the development of land ownership. Name the sources of title in the United States.

What rights have state and federal governments?

Discuss briefly: eminent domain, escheat, statutes of descent, rules against perpetuities, police power, zoning.

Explain how liens, contracts, and easements may be considered as limitations upon ownership.

CHAPTER XV

INTEREST IN REAL PROPERTY

1. *Property*.—In legal language, the phrase, “real property,” means the right to use, enjoy, and dispose of a certain piece of real estate. As the word is used among those who deal in real estate, it includes realty and personalty. To the ordinary man, property means a certain piece of land with an improvement erected upon it, in other words, the thing itself. Real property includes real estates, lands, tenements, and certain hereditaments springing from the fee.

A further distinction is sometimes made between a real and a personal interest in real estate. By a real interest is meant one which is to continue during the life of one or several persons, or for an indefinitely long period. Conversely, any interest which is for a period less than a life is a personal property interest.

2. *Fee simple*.—The fee, fee simple, or fee simple absolute, as it is variously called, represents the largest possible interest that any individual or corporation capable of holding real estate can possess. All other interests in real estate are either splittings of the fee or parts of the fee. The fee is the type of ownership that is the subject of most sales today, because, being the fullest interest that can be obtained, it is conse-

quently more easily sold, mortgaged, leased, or otherwise dealt in. It becomes very important, therefore, for us to determine exactly what constitutes a fee simple.

Individuals frequently have thought they were buying a fee, only to find that they were buying some life estate which was of little or no value. Years ago, the courts in many of the states decided that the words, "heirs and assigns," following the granting and holding clause of a deed, created an interest in fee simple. The idea behind this decision was that giving property to a person and his heirs and assigns, forever, gave him the absolute disposal of the property. Recent decisions have held that the words "heirs and assigns forever" are no longer absolutely necessary as long as the intention to create this fee ownership was present. But because of the fact that a strong presumption is raised, where these words of limitation appear, that there is a fee simple, they are still commonly used in creating an estate of that nature today.

Two phases of the fee need to be distinguished, namely, the naked title or legal ownership, and the right to use, enjoy, and possess. These two phases are separable, as can be seen in the case of leaseholds, in which it often appears that a tenant's interest is of more value than the owner's. As far as the income is concerned, this is usually true, but it must not be forgotten that the lessee's interest is only a part of the fee simple, namely, the right to the use, enjoy-

ment, and possession of the property, and, moreover, this lessee's interest does not include the right to alienate.

3. *Life estate*.—A life estate may be defined as the use and enjoyment that an individual or corporation may have in a piece of property, contingent upon the life of an individual. The contingency may be determined upon the life of the person who is to use the property or upon the life of another, as when land is given to A to be used during the life of B, rather than during A's life. In either case, a life estate is established.

It can readily be seen that a life estate, unlike the fee simple, cannot be the subject of alienation. To illustrate, let us assume that A has an interest, during his life, in a property and that, because of his youth, this is an interest on which someone is willing to negotiate either a leasehold or a mortgage loan. As long as A lives, the interest of the lessee or the mortgagee is adequately protected. But assume that, shortly after either the lease or mortgage is executed, A dies. The interest of the mortgagee and the lessee will be determined as of that date. A further analysis of the interest of the mortgagee in a life estate shows that, since the life tenant has died, the mortgagee has absolutely no right to foreclose or otherwise protect his mortgage.

It is sometimes thought that it would be possible to proceed against the owner of the fee or the remainderman, as he is sometimes called. But this is impos-

sible, because the mortgagee's interest came from the person who gave it to him, in this case a life tenant, and the interests of both mortgagee and life tenant are terminated by the latter's death. The same is true for a lessee whose rights are derived from the interest of a life tenant. The life estate is not, therefore, a salable or marketable interest in property and usually arises out of a will of a deceased person rather than by deed.

It would, however, not only be possible, but highly advisable, for the lessee or mortgagee to take out a life insurance policy on the life of the holder of the life estate, and thus protect his interest. If this is done, the rental should be low enough, or the interest on the mortgage high enough, to allow for the payment of the premium on the life insurance policy, and yet leave a fair return on the investment.

4. *Remainders*.—A remainderman's interest, as the name implies, is an interest in a fee simple passing to an individual or corporation at the termination of a life estate. Remainders can be divided into two types, vested and contingent. Both are future estates. A remainder is vested when there is a person living who would have immediate right to the possession of the property on the termination of all life estates. It is contingent when the person or the event on which it is limited is uncertain.

If a property is given to A during his life and the remainder to B, without qualification, B is the owner in fee simple of the property, but his right to use,

enjoy, and possess the same is withheld until the death of the life tenant A. On the other hand, if it were deemed advisable to sell the property, it would be necessary for B to execute the deed, since he is the remainderman and owner.

The contingent remainder is one not only subject to the use and enjoyment of a life tenant, but subject to a further contingency which may result in absolutely no ownership becoming vested in the remainderman. For example, if property were given to A for life, and the remainder to B, provided that A died leaving no children, B would have a contingent remainder. It could not be determined until A died whether B's interest would materialize, the understanding by the provision being that, if A were to die leaving children, his children would take the property and B, the contingent remainderman, would get nothing.

The state laws with reference to remainders tend to construe for a vested rather than for a contingent remainder, and then only where the contingency is definitely set forth.

5. *Dower*.—Dower is the interest that a widow has in the estate of her husband. It is usually admeasured as one-third of the income, for life, from all of the real property owned by her husband during the marriage period. The prerequisites necessary to establish a valid dower right in property, are, first, a valid marriage; second, ownership of real property by the husband during the marriage period; and

third, the death of the husband. During the life of the husband, the widow has what is called an inchoate right of dower, which is merely a right to succeed to the dower right, providing her husband predeceases her. In other words, the inchoate right of dower is strictly a title or claim of dower.

Many people misunderstand the actual value of the dower claim of a widow, thinking of it as a one-third claim to all property owned by the husband. This is not true. The dower right affects only real estate, and its actual value must be calculated in every instance. Both the income of the property and the age of the widow must be considered. The older the widow is, the less she receives. In admeasuring dowers, use is made of the mortality table, and the older widow is deemed to have a less time to live and to have, consequently, a lesser interest in the real property owned by her husband. This interest is not a fee simple, but only a life estate.

6. *Disposal of property affected by dower.*—If a husband dies intestate, that is, without leaving a will, and is survived by children, as well as by a widow, the ownership of the real property is vested equally in the children. They become the owner in fee simple, subject only to the dower claim of the widow. In order to effect a valid sale of this property, only the children need sign a deed to pass title. The widow signs the deed only to release her dower claim, or, without signing the deed, she may execute an instrument called release of dower.

Cases have arisen where a married man has attempted to sell his real property, while designating himself as unmarried or a widower, in an effort to cut out his wife's dower, and innocent purchasers for value have sought to establish good title by relying on the husband's statement. It is clear that in such a case the widow's rights are fully protected and her claim against the property undenied.

A successful annulment action, regardless of by whom it is brought, eliminates the dower right because an annulment determines that the relationship of husband and wife never legally existed.

In some of the Canadian provinces dower has been abolished, but in all provinces the widow shares, with the children, upon an intestacy, and usually the widow is entitled to a one-third interest. This is entirely apart from her dower right. In Ontario, she may elect to take one-third absolutely in the undisposed-of realty of her husband, in lieu of all dower.

7. *Effect of marital difficulties on dower.*—If only an action for separation is involved, the dower right is in no wise affected. But if the wife brings an action against the husband for a divorce, she loses her dower right in property acquired by the husband after the final decree of divorce. This is logical, because a decree of divorce vitiates the relationship of husband and wife. If, on the other hand, the husband successfully brings an action for divorce against his wife, there is no dower right of any kind in any

of the property, either before or after the final decree of divorce.

If the husband divorced by his wife remarries, the question naturally arises—Is there a double dower right to the property acquired during the first marriage? The answer is that both wives are entitled to dower rights, but the first wife has a prior claim, and the second wife does not succeed to any dower rights unless she outlives the first.

The statements made above are true with respect to dower states. In New York, after September 1, 1930, under the new Decedent's Estate Law, provision will be made for the surviving spouse. The new law states, in substance, that the real property of a deceased person, male or female, not devised, shall descend, and the surplus of his or her personal property after payment of debts and legacies, if not bequeathed, shall be distributed to the surviving spouse by giving to her one-third thereof. This revision of the old statute abolishes dower and curtesy, and gives, in their stead, moreover, an outright third of both the real and the personal property to the surviving spouse.

8. *Curtesy*.—Curtesy, a supposedly reciprocal right of dower, is an estate dependent upon marriage, seisin (ownership), issue born alive, and death of the wife. More conditions must be met to establish right of curtesy than for the right of dower.

For example, in dower there need be no children born of the marriage, but a husband is not entitled to

a curtesy right unless a child has been born alive. The courts have decided that the test in this case is whether or not the child has uttered a single cry. The prerequisites of a valid marriage and the death of the wife are the same as in dower, but if the wife disposes of her property during her lifetime or devises it by will to someone, the husband thereby loses his right of curtesy.

There has been considerable agitation in favor of placing the dower and curtesy rights on a par, or of disposing of them entirely. The new statute of descent in New York seems satisfactorily to have answered this by abolishing both, giving the surviving husband one-third of the real and personal property of his wife.

9. *Tenancy in common*.—Whenever an interest in property is devised to two or more persons, they are deemed to hold as tenants in common, unless it is otherwise definitely agreed upon. There being no limitation, each tenant owns an undivided share, which is absolutely subject to his disposal. Each can sell his interest, or mortgage or lease it.

If the interest of one holding tenancy in common is not disposed of during the person's lifetime, it passes to the proper descendants, according to the statute of descent of the particular estate. A fiduciary relationship is supposed to exist among parties holding as tenants in common, and the courts have decided that they cannot purchase an outstanding claim or dower to the exclusion of their co-tenants.

10. *Joint tenants*.—Joint tenancy is created in the same manner as a tenancy in common, except for an express declaration of the element of survivorship, which is the outstanding difference between the two. In joint tenancy, there is supposed to be a unity of interest, title, time, and possession. The interest of each must be the same. It must be created by the same instrument and each must have possession of the whole property.

During their lifetime, the joint tenants may dispose of an individual interest, but should this be done, the person to whom a joint tenant's interest is conveyed holds as a tenant in common with the surviving joint tenant or tenants. Husband and wife, who usually hold property as tenants by the entirety, in some states hold it as joint tenants, if the intention to do so is made clear.

11. *Tenants by the entirety*.—This interest arises where a husband and wife take title to property in their own name, and can only arise where there is the marital relationship. To understand the unity under which this interest is held, it may be explained that its origin is traced back to common law, wherein a husband and wife constituted but one person. It is usually created by adding after their names, in the deed, "As tenants by the entirety," but, if both are mentioned in the deed, no further words are really necessary. If the deed runs to a person designated as wife who, as a matter of fact, is not, there is created only a tenancy in common. Divorce severs

this interest of husband and wife, and changes their status to that of tenants in common.

In all Canadian provinces where the Married Women's Property Acts are in force, enabling a wife to take property as if she were a *feme sole*, it seems to be clear that husband and wife take as tenants in common. It has, at any rate, so been held in Ontario.

12. *Community property*.—The statutes of some of the western states do not recognize dower, curtesy, or tenancy by the entirety. In their stead, husband and wife are said to have a community interest in property held during the married state.

There is little uniformity in the rules governing community property except that, in general, husband and wife hold as partners. In some instances, the law recognizes separate property as being any property acquired by either husband or wife before marriage; in other cases, it is construed to be any property given directly to husband or wife after marriage, together with any accumulations or additions thereto.

In the province of Quebec, husband and wife may be either in community of property or separate as to property. In the absence of ante-nuptial agreement, community of property exists. All real estate acquired by either during marriage becomes common property. The husband has the exclusive administration of the community and can sell and mortgage the property without his wife's consent. Where, by ante-nuptial contract, property is held separately, the

wife retains the administration of her property. She cannot, however, sell or mortgage it without her husband's consent.

13. *Mortgagee's interest*.—The subject of interest in real property cannot be dismissed without calling the reader's attention to the fact that the mortgage in many states is an instrument which transfers an interest in the property from the borrower to the lender. It legally effects a conditional conveyance of the property rather than constituting a lien. In this respect, it is an interest in real property. This is the effect of a mortgage, also, in most of the provinces of Canada. Where Land Titles Acts are in force, the mortgage is a charge or lien.

REVIEW

Explain the terms property, real property, personal property, real estate.

Distinguish between a life estate and a remainder.

What are the effects of separation and divorce on dower?

What is curtesy? State the conditions under which the right may arise.

Define and distinguish between tenancy in common, joint tenancy, tenancy by the entirety, and community property.

Has the mortgagee an interest in real property?

CHAPTER XVI

REAL ESTATE TAXES

1. *Importance of taxes.*—Taxes are an important item in the cost of doing business. Every state has a real property tax, which varies in amount according to the cost of running the city, county, and state governments, and the emphasis of taxation on real property, personal property, or incomes. This variation is from twelve to forty dollars per thousand dollars of assessed value. The average is about twenty-four.

A corporation, in choosing a location for a factory or warehouse, often chooses one location as against another, partly because of the fact that real estate taxes are lower in one city or state than in another.

Taxes directly or indirectly affect the value of real estate. If taxes are so high that the business man cannot make a profit out of his business, and, if high taxes affect other business concerns in the same manner, the demand for property lessens with the falling-off of business, and values decline. High taxes are not usually the chief cause of business recessions, but, if the margin of profit is narrow, a higher tax rate may be demoralizing on the businesses directly affected. If the business man can pass on the burden of taxation to the consuming public in the

form of higher prices, well and good. If he cannot, business failure may result.

2. *Choosing a city with a low tax rate.*—Tables of comparative tax rates for cities of different sizes may be obtained from chambers of commerce and bureaus of municipal research in the United States and Canada. The Detroit Bureau of Governmental Research, Inc., for example, has compiled a table of comparative tax rates, for 1929, of 235 cities of over 30,000 population. This extensive table is invaluable to the business man planning to acquire any considerable amount of property in one of these cities.

We give below a table compiled from the data furnished by cities with a population of 500,000 or more. The rate, as quoted, is determined after making an adjustment for differences in legal basis of assessment, and is in dollars per thousand of assessed value.

TAX RATE IN CITIES OF 500,000

City	Rate
Pittsburgh, Pa.....	\$32.05
Buffalo, N. Y.....	26.64
Philadelphia, Pa.....	25.97
Cleveland, Ohio.....	25.30
Boston, Mass.....	25.20
Milwaukee, Wis.....	23.97
New York, N. Y.....	23.21
Baltimore, Md.....	22.42
Los Angeles, Calif.....	21.30
Detroit, Mich.....	21.16
Chicago, Ill.....	19.40
St. Louis, Mo.....	18.34
Washington, D. C.....	15.30
San Francisco, Calif.....	15.00
Average for all cities.....	24.03

The highest rate for all cities covered in the report was in Tacoma, Wash., and the lowest was in Lancaster, Pa. Among the Canadian cities, the highest rate for those reporting was in Hamilton (33.50), and the lowest in Montreal (17.99).

3. *Theory of taxation.*—The taxation of property is based on the general assumption that governments should be supported by those benefiting from their existence. The right of holding private property is a right upheld by the state and, because of its protection, business and gain become possible. In return, the state reserves the right to collect taxes from property-owners.

The federal government has turned over to the states and other political subdivisions the right to collect real property taxes. This has been done because the states, counties, and cities are closer to the property against which the tax is levied.

Real estate is the most natural form of property on which to make a levy, because it is tangible and immovable, and because it has a value which is susceptible of being used as the basis of a tax. Real property values can be determined more equitably than can the value of personal property.

Real property cannot be secreted as can personal property, both because of its physical nature and because of the fact that title to real property is carried, by law, in the name of its owner on the public records. All of these factors help to make it the natural basis for taxation.

The expenses of government are raised through general taxation. As a rule, all possible sources are relied upon. In the case of the federal government, the income tax is one of the largest sources of income. State governments rely on both income and property taxes. County and municipal governments levy property taxes, franchise taxes, and licenses.

4. *The tax levy.*—The procedure of levying taxes against real property is not a complicated one. The first step is the determination of the city, state, county, or federal budget, which is a composite of financial requirements compiled by the director of the budget from the departmental estimates.

While the budget is being prepared, the assessors and their deputies are out assessing the property against which the tax is to be levied. In some sections, property is assessed at its full market value, while in others it is assessed at 40, 50, 60, or a higher per cent of the market value.

After the total value of taxable property has been arrived at and the budget determined, the next step is to set the tax rate. This is done by first subtracting from the budget the amount of income expected from other sources, such as licenses or franchises, and then dividing the balance which must be raised by the total assessed value of the real property. The result is the tax rate per dollar, per one hundred, or per one thousand dollars of assessed value.

If the citizen thinks that the budget or the assessed value of his property is too high, he has the right to

register his objection and be heard. He may even go into court to ask for a revision of an assessment, if the taxing bodies do not give him just relief.

5. *Valuing property for tax purposes.*—A careful study of assessment methods has been made by David T. Rowlands, of the University of Pennsylvania. His survey shows that there is little uniformity in terminology or in method, although, in most cases, certain prescribed evidences of value are to be used by assessors in arriving at the value of real property for tax purposes.

Mr. Rowlands lists the following as the commonly accepted evidences of value: price at a private or voluntary sale, value if taken in payment of a just debt from a solvent debtor, cash which can be commanded in course of business, price from a willing buyer to a willing seller. In some states, the property is to be assessed at its full cash value or at its full market value.

Several of the state tax commissions have prepared assessors' manuals, consisting of rules and methods of procedure to assist the assessors in their work. Generally speaking, it may be said that the problem of valuing property for tax purposes involves the use of no different principles than those involved in valuing property for other purposes. The procedures described in Chapters IV and V are basic in solving all value problems.

6. *Assessments.*—Assessments should not be confused with the assessed value of the property. The

assessed value of property is the value for tax purposes, while an assessment is a special levy for a local improvement, and is usually made entirely against the property benefited. Sewer, paving, or street-widening projects are examples of improvements calling for assessments. If the cost is large and if the improvement benefits the community generally, part of the burden may be raised through general taxation.

Most governments use their credit in making general public improvements. Instead of meeting the cost of subways, water-works, paving, highways, and public buildings immediately out of general taxation, bonds are issued and sold for this purpose. By this means, a community can enjoy the use of improvements, now, by promising to pay for them out of future income from taxation.

7. *The lien of taxes.*—Taxes become a lien in most states when they are due and payable, the exact date being fixed by statute. If not paid when due, taxes usually become delinquent in thirty or sixty days, and interest is charged on them from then on until paid, or until the property is sold for taxes.

An assessment becomes a lien against the property when the proportionate cost of the improvement has been levied against the property benefited. Past due assessments, or any installments of the same, also bear a penalty rate, which is usually the same rate as is charged upon past due taxes.

8. *Tax sales.*—The laws of all states provide that,

if taxes remain unpaid for a certain period of time, the property itself or a lien against the property can be sold at public auction, and the proceeds used to settle the tax and the expense of the sale.

States which provide that a lien may be sold usually specify that, if the lien is not paid within three years or so, the lien can be foreclosed and the property sold to satisfy the lien. Liens are usually sold to the highest bidder, who is the one who bids the lowest effective rate of interest below a statutory maximum. If the property itself is sold, the delinquent owner usually has the right of redemption by paying the taxes and costs, with interest from the time the property was sold for taxes until redeemed.

9. *Trend of taxation away from real estate.*—The present trend in state taxation is away from a real property tax. In Pennsylvania, New York, Virginia, California, and New Jersey, there is no state tax levied on real estate. Tennessee will shortly join the list. In Virginia, Utah, South Carolina, and Iowa, bills are pending that will result in lightening the tax burden on real property.

Income tax laws have recently been enacted in Arkansas, Georgia, Oregon, and Tennessee. Kansas has pending an amendment to the constitution which will permit the levying of an income tax.

Connecticut, Rhode Island, Maryland, and New York have revised their inheritance tax laws. Many states, including Arkansas, Idaho, Iowa, Indiana, Missouri, Michigan, North Carolina, New Mexico,

South Carolina, Wyoming, Wisconsin, West Virginia, Washington, and Texas, have amended their inheritance laws by adding a reciprocity feature. All of this legislation tends to shift the incidence of the tax from real property to other bases.

10. *Taxes and income*.—The burden of real property taxes becomes evident when a study is made of the percentages of incomes that are consumed by taxes. The rate varies from 8 to 31 per cent.

There is no correspondence between the proportion of income consumed by taxes on rural properties and the proportion consumed on urban properties. In some states, the percentage for rural properties runs very high, while in others it runs low. In general, taxes on city property have risen more than taxes on rural property, but, on the other hand, taxes in proportion to net income run higher, on the average, in the case of rural property.

11. *Provincial and municipal taxation in Canada*.—In Canada, real estate taxes are usually imposed and collected by the municipality in which the land is situated, but any general statement should be received with caution. Each province has its own taxation laws and these laws are being amended from year to year. The province has unlimited jurisdiction as to taxation of land within the province and, even when it gives the municipality the right to tax, that right can be withdrawn or modified by appropriate legislation.

Some provinces are content to tax land in unor-

ganized townships only; others tax land, to a limited extent, for general revenue purposes, using the municipal machinery for collection. Some provinces have taken the precaution of limiting the amount of taxes the municipality may impose on land, but in most cases the municipality has an unlimited right of taxation.

The term "assessment" is usually applied to the valuation of the land by assessors, and the entry of the land and the amount of the valuation on the assessment roll form the basis for taxation. The assessment and the assessment notice are the first steps in the imposition of taxation, and a condition precedent to the collection of the tax. The yearly rate is fixed later by the municipality, and the actual tax may be payable in the year following the year in which the assessment is made. Other assessments, such as special frontage assessments under the Local Improvement Acts, are usually referred to as "special assessments." These constitute fixed charges on particular parcels of land.

"Land" usually includes buildings and minerals, and also machinery and fixtures erected on the land. The Ontario and similar acts exempt fixed machinery used for manufacturing or framing purposes. Bridges and similar structures, gas lines, tracks, poles, wires, and transformers are similarly regarded as land in many jurisdictions.

Most of the provinces reserve to themselves the taxation of mines and minerals. This is usually in

the form of an annual tax on the net profits of the mine. In Ontario, the municipalities may not assess minerals, but both the province and the municipality have the right to tax the income from the mines.

The right to appeal against an assessment is usually limited to a definite time from the date of mailing of the assessment notice. It is too late to object to the tax, if the assessment was not objected to. The appeal is usually to a municipal court of revision, with a further appeal to a county judge. Where large amounts are involved, further appeals are permitted.

12. *The lien of taxes in Canada.*—Taxes due upon land are invariably made a special lien on the land in priority to every claim, lien, or encumbrance of every person, except the Crown. The municipality may sue for the amount of taxes due as a debt; or it may distrain for the taxes upon the goods and chattels of the owner; or it may sell the land at a tax sale.

In most of the provinces, the land is sold for what it will bring. In Ontario, the treasurer sells only so much of the land as is necessary to pay the taxes, selling, in preference, such part as he may consider best for the owner to sell first. If, for example, \$100 is due for taxes and costs, the first bidder may offer to take twenty-five feet for that price; the next bidder may offer to take twenty feet, and so on.

Usually, the owner has one year from the date of

a tax sale to redeem. In some provinces, when the statutory period has expired, the owner is absolutely debarred; in other provinces, the right to redeem subsists even after the statutory period. In Ontario, if the land is not redeemed within the year, the treasurer must make a search in the proper registry office and notify everyone appearing on the title that he is entitled to redeem within a period of thirty days. If the land is not then redeemed, a tax deed is executed and delivered. When the deed has been executed, it is valid to all intents and purposes, unless questioned before a court within two years from the time of sale.

In many jurisdictions, a tax sale will cancel easements and building restrictions to which the land is subject. This is a hardship upon the owner of the adjoining land intended to be benefited by the easement. A recent Ontario amendment requires the assessment of easements in connection with the land to which it is appurtenant. Where a "dominant tenement" is sold for arrears, the easement passes to the purchaser; where a "servient tenement" is sold for arrears, the sale will not affect any easement to which it is subject. A restrictive covenant, running with the land, is an easement within the meaning of this amendment.

13. *Business assessments and other Canadian taxes.*—Many provincial statutes provide for "business assessments." This is not to be confused with a real estate assessment, although it is based upon the assessed value of the land occupied. The business

assessment varies with the nature of the business. A manufacturer, for example, renting space in a building in Ontario, would be assessed for a sum equal to 60 per cent of the assessed value of the space occupied, whereas a person carrying on a financial business would be assessed for a sum equal to but 50 per cent of the assessed value of the space occupied.

As with the land assessment, the assessment is not the tax, but the basis for the tax, depending on the rate "struck" by the municipality. It is not a tax on the land but on the business. The land tax is paid by the owner of the land. If the land owner conducts a business on his land, he is assessed for the business as well as for the land.

School taxes are usually levied by the municipality, and so many mills on the dollar are added to the rate, to take care of school requirements. In some provinces, an additional rate is collected by the municipality and paid to the province for educational purposes.

Some provinces collect a tax on the registration of every transfer of land. In Ontario, this tax amounts to one-fifth of one per cent of the total consideration for the sale, including the amount of any mortgages assumed. Alberta has adopted an "un-earned increment" tax. This is a tax of five per cent on the increase in value, at the time of registration, over the value according to the last preceding valuation, but excluding, in all cases, the costs of improvements or development work.

REVIEW

Explain the general theory of taxation.

How are taxes levied? What is the assessed value?

Distinguish between assessments and assessed value.

Explain how property may be sold to satisfy taxes.

What is the present trend of real property taxes?

What percentage of net income from property is consumed by taxes?

CHAPTER XVII

REAL ESTATE INSURANCE

1. *Guarding against losses.*—It is a well-recognized principle of business that all losses should be reduced to a minimum, since they eat into profits and, if not stopped, may even result in the ruination of the business. In every business, there are certain elements of risk and sources of loss that cannot be entirely eliminated but that can be partly controlled. Losses due to neglect or to carelessness should be reduced to a minimum by the vigilance of management. Losses due to fire, accident, tornadoes, earthquakes, and the like should be covered by insurance.

2. *Real estate risks.*—The real estate risks of a business may be conveniently classified as those which are within the control of management and those beyond its control. Of the former class, the outstanding causes of loss are those due to negligence or to lack of foresight. Property not kept in proper repair depreciates much faster than property that is properly cared for. A foundation, a steel girder, or masonry that is exposed to the elements will waste away much faster than one properly protected. A building poorly arranged, or one not constructed so as to withstand certain stresses and strains, may and

usually does lose value more rapidly than one that is properly designed and constructed. If precautions are taken in planning and in caring for buildings, a large amount of loss can be avoided.

The danger of loss due to fire is a hazard which may not be entirely within the control of the management. Usually, much of the danger of loss by fire can be prevented by warning employees to be careful, by using fireproof materials in construction, and by adequate fire protection. On the other hand, lightning may strike a building, electric wires may become short-circuited, or sparks may fly from other buildings and bring about serious loss.

There are two methods of protecting the business against risks over which the management has little direct control. One is to insure the risk with an insurance company. The other is to carry an insurance fund to cover the risks of loss. This latter method is often called self-insurance.

3. *Kinds of insurance.*—Some insurance companies will insure against any risk if the insured is willing to pay the premium. It is not always advisable, however, for the business man to take out insurance covering every risk, since, in most cases, the cost of carrying the insurance would exceed the probable amount of the loss. Certain well-recognized risks which attend the ownership of real property are covered by standard insurance policies, of which the following are the most usual: fire, sprinkler leakage, windstorm, tornado, earthquake, public liability,

plate glass, steam boiler, power plant, riot, explosion, title, rent, leasehold, and land value.

4. *Title insurance*.—One of the greatest dangers in buying and selling real estate is that of loss from defective or unmarketable titles. This is particularly true because so many things may happen to make the title defective, such as the transfer of some interest in the property by a forged instrument, the transfer of a property on the basis of an invalid will, the execution of a deed by an infant or lunatic, transfer of property by one claiming right to transfer under a power of attorney which later is proved to be invalid, unsatisfied dower claim, undiscovered heirs, a defective foreclosure of a mortgage, undiscovered easements, or restrictions or errors in the description of the property.

The title companies perform the service of searching, abstracting, examining, and insuring the title against loss due to a defect or defects. There are two distinct types of title insurance, and the person interested in securing such insurance should be sure of which kind he is getting.

In the first type, the company insures against errors in the search of the title and against discoverable defects in the title, as shown by the records. This policy guarantees that the ownership and encumbrances, as stated in its contract of insurance, based upon the examination of title by itself or by other examiners, are in accordance with the title and encumbrances as shown by the records. Such in-

insurance will protect the insured against an incomplete description in a deed, or the lack of a signature to an instrument necessary to give clear title to the property, but will not protect against undiscoverable defects, such as frauds and forgeries, instruments executed by infants, undiscovered heirs, and many other hidden mistakes of law or fact.

The second type of insurance protects the insured, not only against errors resulting from an improper search and from defects apparent on the record, but also against all defects which may exist and which the records do not show. This policy insures against such hidden defects as forgeries, false representations, frauds, lost deeds, deeds by infants, lost wills, deeds by lunatics, invalid powers of sale, undisclosed heirs, mistakes of law, misrepresentation of fact, defective acknowledgements, liens omitted from searches, mistakes in description, defective partition suits, illegal trusts, undisclosed restrictions, defective foreclosures, dower claims, invalidity of mortgages, etc.

The only sure way to get absolute protection against a flaw in the title is to insist that a title policy accompany the deed. It often happens that the very protection which the property owner wants is made an exception in the policy. Rigorous scrutiny of the policy must be the business man's rule of action.

5. *Fire insurance*.—Loss due to fire is a risk which distinctly affects improvements to real property. In the earlier days of insurance each company had its

own policy, differing in most cases from those of competitors. Almost every fire loss resulted in a law suit to interpret the insurance contract. The difficulty of collecting claims finally became so great that legislatures enacted statutes requiring certain clauses to be inserted in all fire insurance policies and that a full measure of protection be given the insured. Such policies are known as standard policies.

The standard fire insurance policy covers the following: statement of parties, description of the property, risk assumed by the insurance company, procedure and valuation in connection with adjustment of losses, and cancellation of the policy.

Perhaps the most important part of the insurance contract is the risk which has been assumed by the insurance company. The insurance company usually agrees to pay for any damage by smoke, water, or any other agent incidental to the fire. Insurance companies invariably put certain limitations on their liability. These limitations pertain to a changed condition of the property or to hazards for which the insurance company refuses to be responsible.

The standard fire insurance policy may include additional clauses affecting the interests of mortgagees, tenants, and landlords in the property insured. The mortgagee clause, and the rent and insurance policies, are the most usual of these special forms.

6. *Mortgagee clause.*—The mortgagee usually demands that he be protected against the danger of loss

from fire. Since the mortgagor takes out the insurance policy, the mortgagee can be protected only with the consent of the insurance company and the insured. This is done by inserting a clause stating that, in case of loss, the mortgagee is to receive, out of money due from the insurance company, a sum which equals his interest in the property. Furthermore, the mortgagee is not responsible for any action of the mortgagor in violation of the policy unless he has knowledge. The mortgagee may pay the premium if the mortgagor fails to do so, and the policy cannot be cancelled without giving the mortgagee ten days' notice.

7. *Rent and leasehold policies.*—Fire results in loss to property owners, both through the damage done to the property itself and through loss of rent or income from the property while the damage is being repaired. The remedy against this loss is rent insurance. The company may undertake to pay either the loss of rent from occupied portions or the rental value of the entire building, whether completely occupied or not.

The other form of policy written to cover loss of rents due to fire is called leasehold insurance. If the lease for property held under a long term, and sublet at a profit, contains a clause providing that in case of fire the lease shall be cancelled, the tenant may, in such an event, lose his profit on the lease for the remainder of the term.

To give the tenant protection against the possibil-

ity of such a loss, many of the fire companies are writing a leasehold insurance policy covering this contingency.

8. *Sprinkler leakage insurance*.—The fire hazard in modern buildings has been reduced by installing sprinkler systems, but the result has been to develop a new hazard. This is the possibility of damage to property because of the accidental discharge of the sprinkler system, due to freezing, high water-pressure, excessive heat (not due to fire), a defect in the sprinkler equipment, or accidental injury to the system. Fire insurance companies meet this danger by writing a sprinkler leakage policy.

9. *Windstorm, tornado and earthquake insurance*.—Losses in some sections of the country from severe windstorms and tornadoes have resulted in the writing of another type of standard policy. The windstorm and tornado policy should be scrutinized very carefully to make sure as to the exact risk which is being assumed by the insurance company. In most cases, the policy covers only the loss and damage done by the windstorm, tornado, or cyclone, and does not protect against the fire which often follows them. Damage done by rain or by water from broken water pipes is covered by the policy, providing the water damage came as a result of the wind damage. Damage to window and plate glass is covered to the extent of the proportionate value of the glass to the total value of the property.

Geologists claim that no section in the United

States is free from the possibility of earthquake. If this is true, all valuable property needs to be protected from loss due to this cause. In most cases, however, the possibility of damage and loss due to earthquakes appears to be remote and insurance covering that hazard should be carried only in the recognized earthquake zones. The earthquake policy covers loss done directly to property by earthquakes or volcanic eruptions. Like the windstorm and tornado policy, the earthquake policy does not protect against subsequent damage done by rain or fire unless the earthquake can be shown to be the direct cause of the damage.

10. *Public liability insurance.*—It is a well-recognized principle of law that any person who, through his own negligence or through the negligence of his agents, causes injury to another or damage to the property of another shall be held liable for that injury or damage.

Owners of property are liable for injury to others resulting from the defective condition of the property, and they may also be held liable for damage or injury suffered by others while property is under construction, even though a contractor is in charge. The principle of law which places liability on the owner is based on the fact that the contractor is usually the agent of the owner. In some jurisdictions, however, the owner and contractor are jointly liable; in others, only the contractor may be held liable, since he is directly responsible.

It is important, then, for the business man to ascertain his liability for damages arising from all sources. The next step is to cover the danger of loss by public liability and other insurance that will give adequate protection.

The most common forms of public liability insurance are contractor's, landlord's and tenant's, elevator, and public liability.

11. *Land value insurance*.—Some insurance companies are writing a policy which covers the risk to purchasers of a future decline in the value of the property purchased. This type of insurance has been designed primarily for the purchaser of a small parcel of land, and is particularly valuable to real estate operators and developers who use this policy to help sell real estate. Land value insurance is not generally recognized as a type of insurance to be carried on business property, since well-chosen locations tend to increase rather than decrease in value.

12. *Miscellaneous policies*.—There are risks which are particular to certain properties because of the type of business carried on or because of the hazard of power and heating plants. Damage due to the explosion of a steam boiler may be covered by steam-boiler insurance. Damage to property as the result of the bursting of a flywheel or the breakdown of a dynamo, turbine, or engine, can be covered by power plant insurance. In certain industries, there is danger from various types of explosion, which can be covered by explosion insurance. In other industries,

strikes and riots frequently result in damage to real estate, for which there is available riot and civil commotion insurance.

Plate-glass insurance covers breakage from such causes as door-slamming, explosions, objects being thrown through the window, settling of the building, defective setting of the glass, and the work of window-cleaners or window-dressers. This is a genuine risk which should be properly insured with a company writing a standard policy. Landlords frequently require this expense to be borne by the tenant.

13. *Self-insurance*.—An alternative to insurance with standard companies is self-insurance, by which the business man assumes the same risks as would the insurance company. The insurance company, however, has the advantage of assuming enough risks to diversify the chance of losses occurring all at once in all of the risks assured. If a business concern has pieces of property in several parts of the country, and if every precaution against loss is taken, the company may very safely write its own insurance. Common disadvantages of self-insurance are the need of carrying too large an insurance fund, or a fire or other loss which is not covered by a large enough insurance reserve.

REVIEW

Enumerate the risks of real estate ownership, and the corresponding types of insurance available.

What protection does title insurance give?

Distinguish between rent and leasehold insurance.

State the essential features of public liability insurance.

Do you favor the carrying of land value insurance on an office building? Gives reasons.

CHAPTER XVIII

THE REAL ESTATE BUSINESS

1. *The services of the real estate broker.*—The business man who has a real estate problem to solve must decide whether it will be possible or practicable to handle it himself or within his organization, or whether it will be better to turn the details over to a real estate expert. If the latter course is to be followed, he should know the services that the real estate profession is capable of rendering. In this chapter will be described the scope of the real estate business and also the character and range of its services.

Briefly, the real estate business consists of brokerage and management, but its range of services includes such diverse matters as the buying and selling of real estate, its management, the securing of mortgage loans, financing, assembling of plots, real estate promotions, appraising, placing insurance, planning of buildings as well as the choosing of locations.

2. *Real estate as a profession.*—We have referred, in the foregoing paragraph, to real estate as a profession. This reference may be questioned, by some, as premature. A careful scrutiny of what is being

done in the field leads us to believe, however, that real estate is fast becoming a profession, and that, in fact, the leading real estate men and realtors are in that class now.

If the tests of professionalization are applied to the real estate business, many of the tests will be found to be satisfied now. For example, standards of conduct have been formulated and accepted by the real estate board members. Individual relationships and personal service are being emphasized. Public responsibility is recognized. Training, education, and culture are held forth as necessary qualifications. The fiduciary and confidential relationship that exists between the broker and his client is being recognized, both in the law referring to real estate and in general practice.

The real estate boards and their national association are foremost agencies in making possible a genuine real estate profession. The colleges and universities that teach real estate are doing similarly valuable work in this direction. Brokers' license laws, the vigilance of the courts, and a greater feeling of responsibility on the part of brokers are important factors in this process of professionalizing the real estate business.

The National Association of Real Estate Boards, and various individual boards, have done a great deal to improve the character of service rendered by the real estate broker, through defining and encouraging higher ethical standards of practice. The codes of

ethics adopted by these organizations will, if carried out consistently, place the business on a truly professional plane.

3. *Brokerage*.—The real estate broker, because of his training and experience, is particularly well equipped to serve business as selling, leasing, or purchasing agent. Modern real estate is a decidedly technical field, and only the specialist who keeps in constant contact with its developments can safely direct important real estate transactions. As evidence, consider the expert knowledge which the real estate broker must have of trends in values, rental conditions, construction and management costs, operating expenses, and the legal pitfalls surrounding real estate transactions.

It is often wise to obtain the services of a broker on a commission or a flat fee basis, so that the best interests of the business will be served. The broker is then given the right to negotiate all real estate transactions for the business corporation, acting as its agent and under its authority as the principal.

In the event of having to sell property belonging to a corporation, the property may either be advertised by the corporation itself, if the value is large enough to warrant such an expenditure, or be listed with a broker who specializes in selling that particular type of property.

If a quick sale must be made, it may be better to employ an auctioneer. An auction is not only a good method of disposing of property quickly, but it is a

method which may be used to protect the management from any liability for the sale price. A private sale may bring a consideration which executives and directors will regard as adequate, but which the stockholders will think to be too low. If the property is sold at a properly advertised and conducted public auction, there can be few grounds for criticism and absolutely none for fraud.

4. *Promotion*.—Sometimes a corporation undertakes to assume the functions of a real estate promoter, when considering a tract of land for a site. If done openly, this may result in price-raising and “gouging” by property owners, as they learn that the corporation is bidding for the property. It is often more advisable to carry on the promotion through a real estate broker who is acting for an undisclosed principal. One large industrial concern, having decided to furnish suitable housing for employees, employed a local broker with experience in promotion, who arranged all the details involved in the purchase of the plot, the construction of the houses and, subsequently, the management of all of the properties.

5. *Assembling plots*.—The broker engaged in real estate promotion work will probably fall heir to the job of assembling a plot. This means negotiating with the owners of the separate parcels that go to make up a plot of desirable size for business purposes. A plot all in one piece can very seldom be found that will be suitable for the purpose of a par-

ticular business. The broker must use his knowledge of real estate values and skill in dealing with property owners to get better terms and prices than the business man could get unaided.

6. *Leasing*.—If a property is to be leased instead of purchased, the broker is again in a position to render efficient service in dealing with owners and landlords. Brokerage firms often maintain branches in large cities and have contacts with hundreds of local brokers in the surrounding towns. Such an organization is built up to serve the chain stores and the national manufacturing concerns. Desirable locations can quickly be found for almost any type of business. This service is becoming increasingly valuable to these organizations doing a national business, especially where the executive offices are located far from the desired site for a new branch, warehouse, factory, or distributing point.

7. *Service in financing*.—The real estate broker has valuable contacts with mortgage lenders and a knowledge of real estate financing methods. If a loan is to be obtained from a private lender or from a lending institution, the mortgage broker is the logical man to make the arrangements. If the loan is to take the form of a public issue of bonds or of stock, negotiations can be opened directly with the investment banker or security broker.

The real estate broker's judgment as to the amount of money necessary to purchase a certain piece of property or to construct a certain building is usually

accurate and well worth listening to. He knows cubic foot cost of construction and land values. He knows the cheapest and best methods of raising money for real estate purposes, realizing that sales may depend on his finding a way to finance the purchase and on his contacts with the lenders.

8. *Management problems.*—The large increase in the size of modern business and of its real estate holdings has set up a serious problem of property management. This usually includes the details of caring for the property, making repairs, servicing the buildings, negotiating leases with subtenants, and collecting the rents.

Unless the real estate holdings of the business are large enough to warrant setting up a real estate division, a qualified property manager will do the job more efficiently, and usually at a lower cost. Because of his extensive experience and continuous contact with management problems, he knows where to buy supplies, how to handle the personnel problem, how to account for property values, and what should be the policies regarding repairs and replacement.

9. *Insurance.*—The insurance broker, the real estate broker, and the property manager frequently are one and the same person, especially in the smaller communities. In the larger cities, the insurance broker is usually a separate individual, but frequently the property manager is a better adviser on insurance, because his knowledge of the risks to be guarded against has been acquired through bitter and

expensive experience. An unrepaired stair, for example, may have resulted in an accident and a \$50,000 damage suit.

Because he is keeping the accounts for the property, the property manager knows how much insurance the owner can afford to buy. He is also in a position to know what company is writing the cheapest and best policy, and whether it is advisable for the company to carry its own insurance.

10. *The choice of location.*—The real estate broker's experience in locating various types of business is at the business man's service in solving the problem of locating a new store or office. The real estate broker is familiar with values in different parts of the city, or even in different parts of the country, and can advise both local and national organizations of the best and cheapest sites available for purchase or lease.

The real estate broker comes in contact with a variety of businesses and is able to study the real estate policies peculiar to each. His office is more or less a clearing house for real estate policy, and from his knowledge he is able to assist his clients in formulating new policies.

11. *Planning a building.*—While the business man usually depends upon the architect for the plan and layout of a building, the broker and property manager are able to offer important suggestions. They are in constant contact with purchasers of space and are in a position to know what other business men

want in the layout of buildings and of space. They also assist in getting away from blind traditions in planning. Often buildings are built in a certain way merely because they have always been built that way, when a change in layout will improve the usefulness of the space or increase the rental area. One brokerage firm has instituted a service to clients showing the possibility of changing building designs to reduce the insurance cost.

12. *Appraising*.—The value of real estate is made the basis of establishing rentals, improvements, condemnations, mergers and consolidations, tax rates, public utility and rail rates, financing, insurance losses, sales and purchase prices. For all of these purposes, an independent appraisal is required and, in most cases, it is the real estate broker who is called in to make this appraisal.

The real estate broker is best qualified to pass judgment on values and to give an accurate appraisal, because he is constantly studying sectional trends, the effect of transportation on values, and the many other factors which affect values.

13. *Brokers' commissions*.—The real estate profession is compensated for its services in the form of commissions. In some localities, custom sets the rates of these commissions. Where brokers are members of a real estate board, the commissions are set by the board. Before employing a broker, it is always advisable to ascertain what commission he expects to receive, and whether he is bound by any set rate, as

established by a real estate board. A schedule of the commissions usually charged in a given community can be obtained from the local real estate board.

REVIEW

List the services that are rendered by the real estate profession.

Do you believe that real estate is a profession? State your reasons for or against.

State the advantages of employing a broker for leasing a property.

What assistance can the realtor give in financing a purchase of property?

Discuss the services of the real estate broker in the planning and management of buildings.

CHAPTER XIX

BROKERAGE, AUCTION SALES AND APPRAISALS

1. *Dealing through brokers.*—In the great majority of cases when real property is bought and sold, the transaction is effected by a broker. In large brokerage firms, the business is usually departmentalized, one division specializing on industrial properties, another division on residential properties, another on business properties, and so forth. In smaller firms there may be specialization as to locality.

The business organization may have recourse to the broker, either when selling or when planning to purchase. In acquiring sites for retail locations and in assembling a large plot through the purchase of individual lots, in particular, it is practically essential to work through one or more brokers. The choice of several, rather than a single broker, for assembling a plot is not generally advisable, because the operations are thus decentralized and the activities of a single broker are hampered.

In the sale of real property, the owner customarily lists it with the broker at the price which he hopes to obtain. This price may purposely be placed above the price which he believes he may obtain. So far

as possible, the owner should arrive at a valuation of his property, based upon transfers in the vicinity and upon its income or upon a combination of these factors, and determine a price which is fair.

If he has proceeded upon sound lines of reasoning, he should at all times exercise his independent judgment as to whether to hold out for the expected price or to modify his demand. The broker will, in the interest of the seller and of his own business, endeavor to sell the property at as high a price as the market warrants. If the offers do not come up to the asking price, it rests with the owner to determine whether his price is actually too high and out of line with values, or whether the market is unduly depressed, for the time being, and a fair price impossible of realization.

2. *The choice of a broker.*—It is important to choose a broker who, from the record of his accomplishments, seems best able to serve the business. In some cases, a broker will be chosen who has built up an organization specializing in the type of property or in the vicinity under consideration. In other cases, a broker should be chosen who has the proper contacts with lending institutions, with prospective buyers or sellers, or perhaps even with the politicians. The owner must weigh, too, the relative advantages and disadvantages of an exclusive listing with one broker or a general listing with many.

It is often difficult to judge between a reliable and an unreliable broker. As a general rule, members

of a real estate board are the most reliable, since the ethical standards set by the boards are high and any unfair practice can be brought to their attention and the offender punished. Many states have enacted broker's license laws for the purpose of protecting the public from irresponsible and untrustworthy realtors. Such statutes usually make violations of the law misdemeanors punishable by revocation of the broker's license or by recovery of his commission, or both.

Ordinarily, neither the authority of the broker nor his contract of employment need be in writing. In some states, however, the authority must be in writing or else he must give written confirmation of a listing within a specified time after it is made.

As a means of protecting property owners and raising standards, the broker's license law and the code of ethics of the real estate boards include specific rules and regulations covering employment, the authority of the broker, and his right to a commission.

3. *Extent of the broker's authority.*—The broker may be employed merely to bring a purchaser ready, willing, and able to buy at the price and terms set down by the principal, or he may be given the full authority to execute a contract on behalf of his principal. The broker does not have the exclusive right to sell, nor an exclusive agency, unless so stated in the employment.

He may have, if agreed upon, an exclusive agency, but this does not prohibit the owner from selling the

property through his own efforts. If, however, the broker is specifically given the exclusive right to sell, the owner is prohibited from selling in any manner except through the broker, without paying him his commission. Property for sale or lease may also be listed with several brokers. If a "multiple listing system" is in operation, property listed with any member of the system becomes automatically a listing with every other member.

The authority of the broker may be implied by the circumstances of the transaction. If the seller consciously accepts the services of the broker, knowing him to be a broker, an implied employment arises.

The duration of the broker's employment may be stated at the time when he is engaged, in which event his employment expires when the stated time has elapsed, or when the purpose to be accomplished has been effected. The authority of the broker may be terminated by mutual consent or, if no time limit is placed on the employment, when a reasonable time has elapsed. It may also be terminated by the sale of the property through another broker (if a sale was the intent of the employment), by the death of either party, by insanity, bankruptcy, insolvency, or the destruction of the property.

4. *Duty of the broker.*—It is the duty of the broker to protect the best interests of his principal. He is bound to act in good faith and must use reasonable diligence in carrying out the matters which come within the sphere of his employment. The broker

cannot be both agent and purchaser without the knowledge and consent of his principal nor may he accept a commission from the adverse party, except by knowledge and consent of his principal.

If the agent is authorized to contract for, and in the name of, the principal, he can be held personally liable only as he has exceeded his authority. If the broker does not divulge the fact that he is acting for a principal and contracts in his own name, both he and the principal, when discovered, may be held liable. The broker is liable if he oversteps his authority or if he is guilty of fraud or misrepresentation.

The broker may be given the power of attorney to sign a contract or do some other act in connection with real property transactions. Such agency may be general, which gives the broker broad powers to act for his principal, or the agency may be special, which limits the authority of the broker to one act or one series of acts. For the service which the broker renders, he is entitled to a commission.

It is customary for the seller to pay the commission, even though the broker is employed by the purchaser. In this respect, the custom of real estate agency differs from the general law of agency.

5. *Liability for the payment of commission.*—When does the broker's right to a commission accrue? This question often confronts the business man. Unless the contract between owner and broker provides otherwise, the right to a commission accrues when the

broker has produced a purchaser ready, willing, and able to buy on the terms set by the seller, or subsequently agreed to by him.

The amount of commission which must be paid by the principal may be stated in the contract of employment. It may be at the customary rate, which is usually that fixed from time to time by the local Real Estate Board, or it may be for the reasonable value of the services of the broker.

In some provinces of Canada, the agent's right to sue for a commission is made subject to the statute of frauds; that is to say, he must have an agreement in writing. The Ontario statute reads as follows:

No action shall be brought to charge any person for the payment of a commission or other remuneration for the sale, purchase, exchange, or leasing of real property, unless the agreement upon which such action shall be brought shall be in writing, separate from the sale agreement, and signed by the party to be charged therewith or some person thereunto by him lawfully authorized.

By a separate agreement is meant any document which is so far separate that the land owner is not obliged to sign both agreements when he is signing one. The form of sale agreement ordinarily used by agents in Ontario contains a clause at the end providing for the commission, separated by a line of dashes from the main agreement.

6. *Form of the agreement.*—While, in general, formal contracts of employment are not required by brokers, in some cases and in some localities, they

may be desirable. In such cases, the form of the agreement for an agency not exclusive covers the name of the broker and the broker's address, the listing, the undertaking to find a purchaser, the right to sell, and the right to receive a commission if the property is sold through his efforts. The contract may provide that the real estate board's rate of commission shall be paid. It may also provide that, if the property is sold within so many days after the termination of the contract to a purchaser with whom the broker has had negotiations, the broker is entitled to the commission, provided the names of such prospective purchasers have been given to the seller within a specified period after the termination of the contract.

Next follows a description of the property, a warranty of ownership, and a statement that the property is free from incumbrance, except as stated. Then follows a provision that the seller will, within a reasonable time, furnish an abstract or title guaranty policy, showing a good and marketable title.

The terms of sale appear next, with a statement of incumbrances, the amount to be paid on the signing of the contract, the amount to be paid at the closing, and the amount to be covered by a purchase-money mortgage. The last provision covers the payment of commission by both parties in the case of an exchange. At the end is the place for signatures. The following is a form of non-exclusive agency contract that is frequently used:

LISTING OF PROPERTY WITH AGENT FOR SALE

(Agency not exclusive)

.....

(Name of Broker)

.....

(Broker's Address)

In consideration of your agreement to list the following property, advertising it and otherwise undertaking to find a purchaser, I hereby grant you for months from the date hereof and thereafter, for a period of one year from this date, unless this agreement is sooner revoked by five days' notice in writing, the right to sell my herein-after described property, and agree to pay the regular fixed commission as adopted by the Real Estate Board out of the first purchase money paid on such estate, if the property is sold by you during the continuance of this agency upon the terms herein set forth, or upon any other terms which I may accept, and if it is sold by me within days after the termination of this contract to a purchaser with whom you have had negotiations with respect to the sale of this property, provided that the names of such prospects be submitted to me within days after the termination of this contract.

The property is known and described as

I hereby warrant that I am the owner of said property, that the information given on the back of this instrument is true and that the property covered hereby is free of incumbrances except as stated.

In the event of sale or exchange, I agree to furnish within a reasonable time an abstract or guaranty policy showing a good and merchantable title in me, subject only to incumbrances assumed by the purchaser; and to furnish certificates showing all taxes and assessments paid for all previous years and to pro rate same for current year as of date of deed.

The terms of sale are:

1. Conveyance of said property is to be made subject to incumbrances as follows:

\$....., due with interest at% per annum.

\$....., due with interest at% per annum.

2. The sum of \$..... to be paid by purchaser upon a signing of agreement of sale (describe form) as earnest money, said agreement and earnest money to be held in escrow by for the mutual benefit of parties hereto. Unless, the purchaser shall be entitled to a refund of the earnest money because of the failure of the owner to furnish evidence of good title, the earnest money shall be applied first to the payment of brokers' commission, the balance, if any, to be paid to seller.

3. The further sum of \$..... to be paid in cash or by certified check when I furnish a good and sufficient Warranty (state kind if otherwise) Deed containing the usual clauses and covenants, provided I have tendered a complete merchantable Abstract of Title, or merchantable Title Guaranty Policy, or a Certificate of Title issued by the Registrar of Titles, which shall upon such payment or consummation of sale remain with me, my heirs, or my assigns, as security until all deferred payments are fully paid.

4. The balance to be paid in not more than years from date with interest at per cent per annum secured upon the property, trust deed and notes (describe form) to be delivered to me at time of delivery of deed.

Possession to be granted

If an exchange is made in accordance with the terms set forth on the back of this instrument you shall be entitled to the same commission as if an outright sale had been made, and you are permitted to represent and receive commission from both parties.

You are authorized to submit this contract for signature subject, however, to my approval, and to place a "For Sale" sign on said property.

Singular pronouns of the first person shall be read in plural when this agreement is signed by two or more persons.

Executed in, at this
..... day of, 19.....

.....Owner.

I hereby accept the above agency and agree to the terms and conditions herein stated.

.....Agent

7. *Forms of exclusive contracts.*—The exclusive agency to sell real estate varies very little from the above, except for the provision that a commission shall be paid to the broker if the property is sold by any one except the owner himself.

The exclusive right to sell real estate gives the broker the sole right to negotiate the sale of property. Even if the owner finds a purchaser, the sale is put through as by the broker.

The renting or subletting of property and even the management of property are often turned over to an agent. If this is done, it is advisable to have a definite understanding as to his authority and right to commission for the service rendered. A written agreement should be entered into, covering all of the important parts of the employment.

8. *Auction sales.*—An effective method of disposing of property is by auction, particularly if the property belongs to an estate, or if the plot is large and is to be subdivided. If property is to be disposed of, in the event of the dissolution of a business, a well-

advertised, well-conducted auction is sometimes the safest and fairest method.

The more reputable auctioneers are past masters in the art of high-pressure advertising and high-power salesmanship. They are able to focus the buying urges on a particular piece of property at a particular time, so that the fairest and best possible price can be obtained for the property.

The agreement with the auctioneer is usually an exclusive right to sell at auction, with a provision that the seller pay for the advertising, all or part of the expense of the sale, and a commission at an agreed rate. In many cases the auctioneer also charges what is known as a "knock down fee," which is added to the purchase price of the property and paid by the buyer. The terms of sale are set by the seller with the advice of the auctioneer.

9. *Advantages in buying at auction.*—It should be noted that frequently, when acquiring a site or location for its business, a company will find it advantageous to buy at auction. If the auction should be a voluntary one, it may be advisable to employ the services of a broker who is to be present at the sale.

If it be known that a certain corporation is bidding for the property, competitors, and particularly representatives of the owners, may attend the sale to force up the price. A better price can often be obtained by having a broker act for an undisclosed principal than can be obtained by an officer of the

company. Even in the case of an involuntary auction, when property is being sold under court order to satisfy a mortgage, the mortgagor is usually present to protect his interests. If he sees that powerful business interests are bidding for the property, he may force the price up, whereas if a broker is representing an undisclosed principal, it may be possible to obtain the desired property at a better figure.

10. *Appraisals*.—The business man should know the value of property for the purpose of a purchase or sale. For this reason the methods of arriving at value were discussed at length in Chapters IV and V. Furthermore, it is often necessary to appraise property for condemnation proceedings, for mergers, for consolidations, or for the purpose of fixing rentals.

Such appraisals are normally made by professional appraisers, who make the valuation of property their business. In large cities, the outstanding brokers act as appraisers, or groups of brokers representing the appraisal committee of the real estate board may render such service. Several of the large accounting engineering firms are equipped to make appraisals and are experts in valuing business property. If the property to be appraised is very valuable, and if the appraisal is to be made for the purpose of defending the interests of the business, then a professional or independent appraiser should be employed.

REVIEW

Name the factors that you would consider in choosing a real estate broker.

What governs the authority of the broker?

Describe the duties of the broker to his client.

Describe the main features of a non-exclusive agency agreement.

State the advantages of selling property at auction.

CHAPTER XX

REAL ESTATE MANAGEMENT

1. *The need for management.*—Since 1918, business units have been growing in size, with the result that the real estate holdings of the individual business enterprises have also increased. Some of the large industrial, public utility, and railroad corporations have properties valued at hundreds of millions of dollars. The chain-store movement has also resulted in an increase in the real estate holdings of some companies. At the same time, property values have risen enormously. Retail, office, and industrial buildings are much larger than previously, and multi-tenant buildings have been on the increase, both in number and in size. All these increases have brought with them heavier responsibilities in caring for property.

Years ago, when the property of a business consisted of a ground floor for the retail business, a second floor for the factory, and a third floor for the living quarters of the proprietor, the management of real estate was a comparatively simple matter and was a part of the general management problem of the business. If the roof leaked, one of the workmen would be sent up to fix it. If alterations had to be

made or a partition built, the employees, or even the owner himself, usually did the work. Rents, if space was let out, were collected by the owner. No separate accounting records were kept for the property. No engineers, electricians, or property managers were needed.

Today, the management of a building is a business in and of itself. Building managers are executives of a high order who command, organize, and direct the activities of renting agents, engineers, electricians, plumbers, mechanics, carpenters, porters, cabinetmakers, glaziers, painters, accountants, and purchasing agents. Real estate management is now recognized as a distinct profession in itself.

Business organizations differ in the extent to which they acquire and hold real estate and, consequently, in the policies of managing their properties. Some businesses acquire only as much property as they can immediately use, and the organizations themselves take over the functions ordinarily performed by the real estate manager. Other organizations, such as the chain-store companies, follow a policy of acquiring and holding properties for future use or as investments, and these organizations usually set up a separate real estate department for the management of their properties.

2. *The scope of management.*—Real estate management is concerned, not so much with the buying and selling of real estate, as with its judicious use and care after it has been acquired. Judicious use



Market Street National Bank Building, Philadelphia—a good example of modern office structure, and an illustration of the magnitude of building management in our age.

of property involves planning for its most efficient and profitable use. The care of real estate involves the details of leasing, collection of rents, servicing the property, maintenance and repair of buildings, purchasing of supplies, and accounting for income and expense.

The scope of building management has been very accurately described by Lee Thompson Smith, former president of the National Association of Building Owners and Managers, in the following quotation:

Building management must be assumed to include every branch of work, every individual act which can be done for the benefit of the property managed. . . . As management develops in importance, it develops in complexity, it specializes and organizes, and applies the most modern principles of executive control.

3. *Scientific management applied to real estate.*—System and organization are the essential factors in all scientific management of business activities. Procedures and routines are best carried out when carefully systematized. The coöperation of the personnel in charge of procedures and routines is best secured through a well-planned staff organization. These are the fundamentals in making management scientific.

In applying these fundamentals to the management of real estate, it will be convenient to separate the procedures to be undertaken, as given in the items on the following page:

- (a) The aims of management for each property should be outlined. Certain aims may need to be stressed in the management policy, such as, for example, maintaining a certain character for a building.
- (b) The management problem should be analyzed into the various tasks to be performed. The first task will be to see that the property is in proper condition for renting. The next task is to establish a schedule of rents. Then follows the renting of space. Lastly comes the task of servicing the property and of keeping it in proper repair.
- (c) Each of the tasks indicated should be further analyzed in the light of a careful study of all of the facts obtainable.
- (d) After this job analysis has been completed, the best method of insuring the efficient performance of each task should be decided upon. For example, the task of renting space may wisely be turned over to a broker or renting agent, because he has more contacts with prospective tenants than a building manager normally has.
- (e) As soon as the one best method of completing a task has been adopted, the personnel problem arises. Who is to be chosen to carry on each task of management?
- (f) Finally, the manager must plan carefully the sequence of work and win the coöperation of the employees in following the proper sequence in an efficient manner.

4. Organization of the management department.

—If the real estate management problem of the business is of sufficient importance, a separate management department may be maintained. If not, the

care of the property may be turned over to a real estate management company. In either case, the same duties and functions must be performed. If a separate department is set up, the division of functions may follow the line of putting one group of men in charge of service and the purchase of supplies, a second group in charge of repairs and alterations, and still another group in charge of the accounting.

If a part of the duties of caring for the real estate can be carried on within the regular business organization, the work of the management department will be reduced to a minimum, capable of being performed by one officer in charge, with perhaps an outside man as assistant. In that case, the officer in charge of the real estate department will negotiate leases and supervise the general maintenance of the properties. His assistant will take care of the collection of rents and supervise the actual servicing of the property, the making of repairs and alterations, etc.

The other functions of a real estate department, such as the purchase of supplies, the accounting, and the actual making of repairs and alterations will be performed by the regular purchasing, accounting, and construction departments of the business organization.

Lee Thompson Smith has ably outlined the services of property management in the following schedule:

PROPERTY MANAGEMENT ANALYSIS

(A) General administration

(a) Office management (either agency or salaried)

- (1) General organization
- (2) Selection of personnel
- (3) Assignment of duties
- (4) Supervision of work
- (5) Cost accounting

(b) Policy (for each building)

- (1) Determination of general policies for given building
- (2) Rulings on application of policies to special situations

(c) Charges (for each building)

- (1) Taxation
- (2) Insurance

(B) Department of renting

(a) Determination of rental scale

(b) Selection of tenancy

- (1) Selection of general types
- (2) Passing on individual applicants
 - (a) Character
 - (b) Business ability
 - (c) Financial responsibility

(c) Renting

- (1) Allotment of space—as between tenants
- (2) Arrangement of space—for each tenant
- (3) Alterations
- (4) Closing sale
- (5) Form of lease and supplemental agreements

(C) Department of service (personal)

(a) Tenants—handling after renting

- (1) General contract
- (2) Special situations—complaints

- (b) General service
 - (1) Janitors (all branches)
 - (2) Elevator operators
 - (3) Water
 - (4) Electricity
 - (5) Steam
 - (6) Miscellaneous
- (c) Special service
 - (1) Electricity
 - (2) Steam
 - (3) Ice and water
 - (4) Towels
 - (5) Clock service
 - (6) Miscellaneous
- (D) Department of operation (mechanical)
 - (Sometimes combined with (C) Department of service, above)
 - (Sometimes combined with (E) Department of construction, below)
 - (a) Coal—testing—buying and firing
 - (b) Boilers and steam-heating
 - (c) Power plant, pumps and other machinery (except elevator)—repair, operation
- (E) Department of construction
 - (a) Kinds of work—all elements of a building and its equipment, particularly:
 - (1) Roofing
 - (2) Flooring
 - (a) Tile or marble.
 - (b) Concrete
 - (c) Wood
 - (3) Partitions
 - (a) Tile
 - (b) Metal lath and plaster
 - (c) Tile and glass
 - (4) Plastering
 - (5) Wood or metal trim

- (6) Radiation
- (7) Plumbing
- (8) Electrical
- (9) Painting
- (10) Calcimining
- (b) Occasion of work
 - (1) Repairs
 - (2) Alterations
 - (3) Improvements
 - (4) Tenant work
- (c) Management of work
 - (1) Diagnosis of situation and its requirements
 - (2) Plans of work required
 - (3) Specifications of work required
 - (4) Letting contracts
 - (5) Supervision of work
- (F) Department of auditing
 - (a) Income
 - (1) Billing
 - (2) Collection
 - (3) Credit and extension
 - (4) Bookkeeping
 - (b) Disbursements
 - (1) Auditing and vouchering
 - (2) Bookkeeping
 - (3) Classification and cost accounting

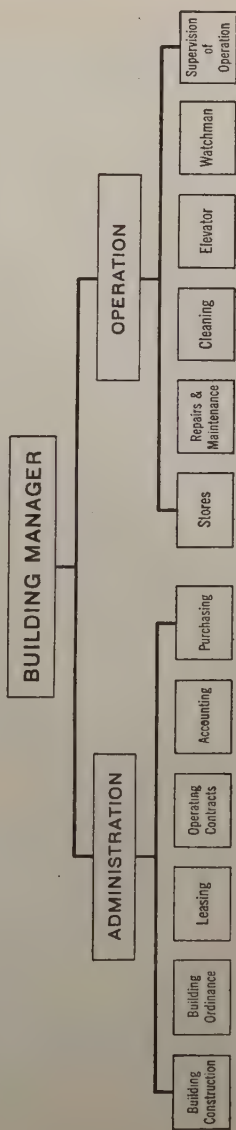
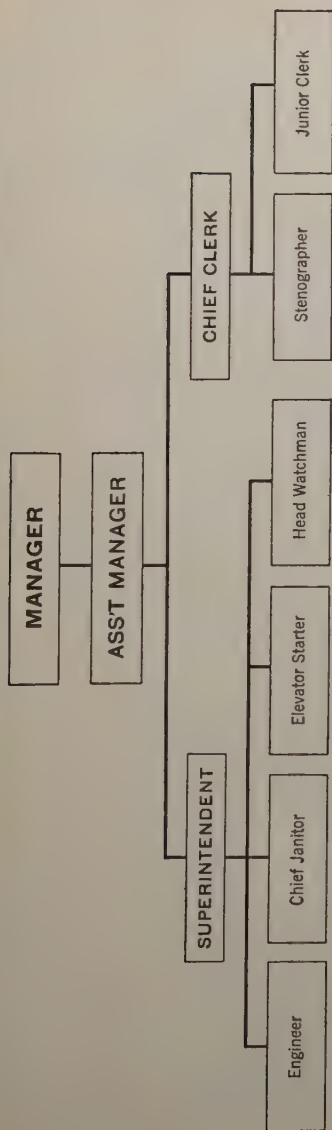
5. *Organization Chart.*—If the management of real estate is to be turned over to a well-organized, well-rounded building management department, its work may conveniently be divided into the two main activities of administration and operation. The building manager will be directly in charge of the administrative functions, assisted, if need be, by an assistant manager and a chief clerk. The operation

of the building will be directly in charge of the superintendent or chief engineer, responsible to the manager, thus carrying out a strictly line type of organization, such as is generally found in the smaller industrial plant. The charts on page 287 show the main functions to be performed and the organization of the management department.

6. *Qualifications of manager and personnel.*—Real estate management calls for a very high type of executive, largely because the line type of organization is necessarily used, centralizing all responsibility in one man at the top. Many of the tasks of building management are of an emergency character, for the performance of which centralized authority is necessary.

The requisite standard of knowledge and capacity is above the level that can be expected of the inexperienced employee. The property manager should be familiar with every phase of building administration and operation. He should possess some knowledge of building design and construction, and be familiar with the operation and construction of mechanical equipment. He must be an architect to the extent that he can read plans and specifications, and know something about materials.

The property manager must be informed on building codes and the municipal ordinances affecting the construction, operation, and care of property. He must be well qualified to act as a renting agent and to direct the leasing of space, possessing the neces-



Organization charts to show: (a) Organization of personnel of a management department; (b) Distribution of functions for which the manager has ultimate responsibility.

sary tact and diplomacy so that he can deal easily with prospective and present tenants. He must avoid giving offense, but at the same time must be firm but diplomatic in refusing to render services to tenants that cannot or should not be rendered. He must be resourceful in devising economies in building administration and operation. With respect to his employees, he must be consistent in upholding the personnel policies of the management, while succeeding in commanding their respect and coöperation.

The choice of employees to perform the tasks of management is a problem of increasing importance. The type of employee who is a tinker or handy man is passing, and specialization of labor is gradually taking place. Modern mechanical equipment, as used in large buildings, is delicately adjusted and requires a trained expert to operate. Even scrub women and janitors must be carefully chosen with a view to securing efficiency and honesty. Many building managers are finding it necessary to bond all employees.

Tenant goodwill is the greatest asset that a building can have, and is secured by the broadest and most considerate treatment of tenants consistent with a proper regard for the financial interest of the owner. Petty exactions and annoyances tend to create a spirit of antagonism, and often result in a loss of income far in excess of the cost of remedy. Tenants desire to be allowed to live in their apartments or to do business in their offices, undisturbed by

trivial vexations, and are highly appreciative, as a rule, of good service and friendly attention, but equally sensitive to inefficient service and lack of courtesy and neatness in employees.

7. *Administrative functions of management.*—An examination of the chart of management functions accompanying this chapter shows that twelve principal lines of activity are charted, six each to administration and operation. Building construction, the first of the administrative functions on the chart, will be discussed in detail in the chapter following. Building ordinance, next in order, covers the heating, ventilating, plumbing, electrical equipment, fire protection, safety appliances, and sanitary equipment of the building.

Ordinance requires the services of an expert or engineer who is well informed on the problems of choosing and caring for such equipment. It is usually good policy, however, to choose the most efficient or the most effective type of equipment and then see that it is kept in proper repair and in proper running condition.

8. *Problems involved in leasing of space.*—Intelligent renting of space involves an analysis of the building or property as to type, shape, size, equipment, layout, service, location, and convenience. If the amount of space to be rented is large, it may be advisable to make a survey of general rental conditions in the community so that rents can be intelligently fixed.

The rental of space may also involve an intensive selling and advertising campaign. Brokers or renting agents may need to be employed to assist in leasing the property. An advertising campaign budget must be laid out, suitable advertising mediums chosen, and effective copy written.

Problems will arise, in connection with the renting of space, involving the character of tenants, amount of rental, term of leases, provision for alterations and repairs, cancellations, subletting, security on leases, and concessions. Every business manager wants his building to have a reputation in keeping with the type of building, and to secure the type of tenant who should logically take space in the building. It would be folly to allow even light manufacturing in a strictly office building. Tenants should be accepted only after careful investigation.

The amount of rental that can be charged will depend upon the character of the location and the type of the building, and upon the rentals that are being asked for similar space elsewhere. A good renting agent attempts to get all that can possibly be gotten for space. Rentals must be charged that are high enough to cover operating expenses, taxes, interest on mortgages, and such a return on the equity as will make it worth while for the business to hold real estate as an investment.

9. *Other problems in leasing.*—The term of the lease will depend upon the type of building, the type of tenant, and upon custom. If the building is a

high-class structure, longer leases can be given. If the building is one which may soon be torn down and replaced by another, it may not be advisable for the manager to execute long-term leases unless a cancellation clause is included.

If a tenant desires that certain alterations be made, the problem arises as to who is to make and pay for them. If the lease is for a long term and the tenant a responsible party, the landlord may agree to make alterations as an inducement to renting. If the lease is for a short term, or if the cost of making the alterations is very high, the landlord may well insist that the tenant pay for the alterations. In some instances, the problem of who is to pay for alterations ends in a compromise, with the landlord paying part of the cost in the form of a concession on the rent, or vice versa, the tenant paying part either in cash or in the form of additional rent.

The responsibility for keeping the building in proper repair is another phase of renting which must be covered in the lease. In most cases, the landlord is made responsible for repairs to the outside of the building, while the tenant is responsible for keeping the interior in good repair. If the lease is a net rental lease, the tenant must make all repairs. Whatever the arrangement, it is important to have it written into the lease. Most leases provide that the property may not be sublet without the written consent of the landlord.

Landlords frequently attempt to get some kind

of security from the tenant as evidence of his good intentions. Security may take the form of a cash deposit, a bond, or certain alterations or improvements made to the property.

For new buildings, it is often found necessary to secure tenants, to make concessions in the way of making especially fitting decorations, or in the form of one or two months' free rent at the beginning of the lease.

Concessions are not usually made to tenants in high-class property, since there is no difficulty in renting the space. Some landlords refuse to make concessions of any kind under any conditions. The policy which should be followed will depend upon the type of property, upon custom, and upon conditions in the market for space.

10. *Collection of rents.*—The difficulty of collecting rents depends upon the type of tenant and upon general business conditions. Collection is a much easier task, if the collection procedure is standardized and well understood by the tenants. For this reason, a system of collection should be carefully worked out.

Collections may be made by a collector calling in person or rent bills may be mailed out. It is perhaps preferable to mail bills and then to call in person on those who do not pay promptly. Personal letters should be sent to tenants who fail to remit payments, and, if necessary, notices that legal action will be commenced to dispossess the tenant. Finally,

if payment is not made, action must be taken. Payment of rent is a periodical expense that should be promptly met, for the best interest of the tenant himself as well as of the landlord. Arrears are hard to overcome.

It is the duty of the manager to reduce losses to a minimum. Rents must be collected and bad debts from uncollected rent must be prevented. One of the best methods of guarding against loss is to get tenants in the habit of paying their rent promptly, and to educate them to the fact that, if rents are not paid, action will be taken immediately.

11. *Accounting for property.*—The accounting for property does not differ from other phases of business accounting except that usually real estate accounting is much simpler in form than the accounting for a manufacturing or trading business. Income must be accounted for. Since income usually comes from one source, namely, the rentals, this is an easy task. Expenditures are made for service, repairs, and maintenance. These items of expense do not involve the keeping of many accounts and so this part of the accounting problem is simple. The accounting necessary for estimating the value of the property is not complicated nor is the accounting for mortgages.

In most instances, unless the real estate is held by a separate company, the real estate accounting is done by the regular accounting department. If this is the case, the management department must work

out a system of reports upon which to furnish the data necessary for the accurate recording of financial facts about the property.

Cost accounting systems are available for building management. Not only have the costs of the various items of operation been segregated, but the cost of doing certain jobs has also been analyzed. For example, the labor and material cost of scrubbing corridors has been made the subject of study, as also the cost per person of elevator service. Studies in depreciation and obsolescence have been made in order to standardize accounting procedure on these items.

12. *The importance of using forms.*—Forms greatly simplify record keeping and, in addition, facilitate the administration of real estate. All contracts with tenants, contractors, and those who supply service and material in connection with operating the building should be standardized, so that it will be necessary to consult a lawyer only on unusual features of such contracts. The accounting system may be reduced or simplified by forms and separate record sheets. A job cost system can be employed that results in standard forms for job specifications. Employees' applications should be reduced to forms.

Daily report forms showing consumption of fuel, electric power, steam, oil, water, etc., should be used. A system of stores-keeping and requisitioning must be worked out, which again calls for forms. Rules

and regulations must be drawn up and printed. Purchase and requisition forms should also be used to simplify the purchasing procedure.

The watchmen must have forms on which to report unusual happenings and the routine of their inspections. Cleaning schedules must be worked out and order-of-work sheets may be drawn up to outline workers' duties. Daily report forms for absentees, for materials used or needed, and for showing the condition of the offices and public places in the building may also be used to advantage.

13. *Purchasing*.—If a purchasing division is maintained in the management department, it must collect information as to the quality, price, and delivery time on the supplies and repairs needed in the operation and maintenance of the property. Different grades of materials must be investigated, as well as the different supply houses which furnish the supplies and repair parts needed.

14. *Operating tasks of management*.—The operation of the property involves its servicing. This means the furnishing of light, heat, and elevator service, the submetering of electricity, the washing of windows, and the cleaning of halls, offices, and washrooms. The operation of the property is a job in itself, particularly if the building is a large one. It involves the employment of engineers, electricians, and other skilled mechanics, as well as of cleaners and scrub women. Furthermore, the energies of the corps of employees should be skillfully directed

so that the most efficient results may be obtained.

The maintenance of the building and its preservation in proper repair are very much akin to the task of servicing. In many cases, the operating staff is also available for maintenance and repair work. Since this is not always possible, contracts must often be let for the doing of such work as painting, special electric wiring, roof repairing, carpentry, masonry, and alterations.

Even if a large staff of repair men, capable of making every type of repair, is employed, unforeseen emergencies may arise, requiring outside assistance. Nearly every well-managed building has a working arrangement with some repair service concern, which is equipped to render immediate service, in an emergency, at any time of the day or night. If such service is employed, signs should be put up in corridors, in washrooms, and in engine rooms, stating that in case of emergency the service agency is to be notified immediately.

It is also the duty of the management department to draft policies to be followed in the maintenance of the property. For example, policies must be formulated as to how often painting should be done, the grade of paint to be used, and whether or not a crew of painters is to be employed at all times or whether all painting shall be done by contract.

Strictest orders should be given against the admission of parties to leased premises after business hours, unless on order of the lessee. Discharged em-

ployees, and others, not infrequently attempt to gain access to offices and apartments for purposes inimical to the interests of the tenants. Neither the landlord nor his agents have any legal right to enter or give access to leased premises, except for specific purposes stated in the lease.

REVIEW

Define management and describe the services rendered by the building manager.

What is meant by scientific management? How can scientific management be applied to real estate?

Describe the organization of the management department.

State the chief qualifications for a property manager.

Describe the operating tasks of management.

CHAPTER XXI

THE PLANNING AND LAYOUT OF BUILDINGS

1. *The needs of a business for space.*—Without attempting to encroach upon the work of the architect, or to make a study of building design and construction, it seems desirable to offer certain fundamental considerations for the guidance of the business man in estimating his needs for space, and in judging the adequacy of building plans and layouts for meeting those needs.

The demand for space varies with the type of business and the particular set of operations or activities to be carried on. For a manufacturing company, there must ordinarily be provided a factory and sales and executive offices. These may be under one roof or all three may be located in different places. Light manufacturing is usually done in a loft building or, if the manufacturing process is extensive, a separate building may be necessary. Heavy manufacturing is usually done in a separate building especially designed for that purpose. Extractive industries must be provided with storage or even processing facilities, besides an executive or sales office.

The wholesale business must be provided with warehouses or storerooms located so as to be con-

venient for the handling of both incoming and outgoing merchandise. Since the wholesaler is buying from producers and selling to retailers, there must be adequate quarters, not only for executives, but also for the buyers and for the salesmen. As a general rule, jobbers do not require nearly as much space as wholesalers, since the jobbers are not forced to carry a large stock of deliverable merchandise. They need maintain only a sample room, executive quarters, and a salesroom. Retailers must be in possession of sufficient space to display their wares properly and to keep an adequate supply of merchandise to make sales until delivery on new goods can be obtained. In some instances, warehouses are maintained near the store in addition to the general storeroom on the premises.

2. *Space requirements of financial institutions.*—These vary with the type of institution. Banks usually choose a ground floor location in keeping with the dignity of the business. Ground floor space alone may not be enough to accommodate the needs of the bank. If the bank is a small one or a branch, two or three thousand square feet on one floor may suffice to accommodate all of the operations. The large banks and trust companies need additional space for the accounting and other routine departments.

Insurance companies, law firms, accounting firms, advertising companies, engineering and other advisory and facilitating organizations usually find adequate accommodations in office buildings. The

space necessary to accommodate these facilitating groups may vary from one or two rooms to whole floors or even to entire buildings. Many of the insurance companies carry on a large enough number of operations and employ a large enough staff to occupy not one but several buildings. The Metropolitan Life Insurance Company, for example, filled one large building and then had to build an annex to accommodate the expansion.

3. *Anticipating space needs set by business expansion.*—Any estimates of the requirement of a business for space must take into consideration the future expansion of the business. Some plants are inadequate almost as soon as they are built. Growth may be anticipated very conveniently if a factory can be built in units. These units may be erected in close proximity to one another, or some may be built near the sources of raw materials or scattered among the more important centers of distribution.

If expansion takes place at an existing plant, either of two accepted plans of acquiring additional space may be considered, namely, the circular and the parallel plans of expansion. The circular or radial plan provides for factory growth, outward, from a central building considered as the hub or axis of construction. The parallel plan provides for factory growth in units placed side by side, in one row or in rows.

A business which uses office or loft space may anticipate expansion by taking any additional space available in its present location or by moving to an-

other building. If a concern which is using a whole building finds itself cramped for space, it may build an annex, tear down its present building and construct a new one, or sell and buy elsewhere. Many concerns wisely acquire more space than is required for present needs, in anticipation of future growth. The space not immediately utilized by the business is leased out for short terms, permitting the corporation to take over these offices or floors for its own use as fast as required.

4. *The economic height of buildings.*—Structural engineers, architects, and builders have made various studies of the economic height of buildings in an effort more effectively to fit the building to the needs of the business for space, to facilitate the flow of work through the factory, or to show the highest rate of return on an office or loft building investment.

The economic height of a factory depends upon the character of the manufacturing process. In some cases, it is only possible to carry on the operations on one floor. For example, nearly all of the work done in a steel mill is done on one floor, owing to the great weight of the product and of the manufacturing equipment. Hoists and overhead conveyors are used to facilitate the flow of work in process, instead of depending entirely upon gravity.

In some instances, the economic height of the building will be determined by the distribution problem and by the volume of production. For example, in the white-bread baking industry, it might seem ad-

visible to build one large seven- or eight-story plant for a city like Chicago or New York, with sufficient capacity to supply bread to the entire city. This plan cannot be followed to advantage, as a matter of fact, because of the problem of distribution involved in the baking industry. Several bakeries convenient to as many centers of distribution are required to handle the volume of business, the size of each plant depending upon the volume of production. In New York or Chicago, a three-story bakery is the economic height. In a city of 200,000 to 500,000 population, bakeries of from one to two stories are preferable.

The economic height of an office or store building will be affected by the demand for space, which in turn depends upon the size of the city. In large cities, where land values are around \$200 per square foot, the economic height of an office building is from sixty to sixty-five stories. If land values run as high as \$400 per square foot, the economic height is about seventy-five stories. In a city of 25,000, the economic height is about six to ten stories.

The size and shape of the plot are also factors affecting economic height. The most suitable ground area for a sixty-five-story building is a plot about 200 feet by 400 feet. Other factors of importance affecting the economic height of an office building are the city zoning and building restrictions, the efficiency of layout, and construction costs. Some authorities are of the opinion that a 150-story building would present, in addition to a construction prob-

lem, problems of elevator, lobby, and street congestion that would more than outweigh the advantage of added height.

The economic height of a department store or specialty shop building in a large city ranges from one or two to eight stories, depending upon the volume of business and the number of lines carried.

5. *Considerations of layout, construction, and design.*—While it is beyond the scope of this book to present the principles of factory layout or to cover the work of the merchandising manager in laying out the departments of a store, it may be well to indicate, by an illustration, the importance of planning space to meet the needs of the business.

Not long ago, several architects submitted plans for a proposed building. The choice finally narrowed down to two plans which were the same as far as cubic foot content was concerned. One plan, however, showed a 2.55 per cent advantage in the ratio of service area to gross area, provided one more elevator, and resulted in a 2.7 per cent increase in the ratio of gross income to net construction cost. Efficiency of layout alone may result in the more economic utilization of space, and affect the company's return on its real estate investment.

The type of construction and materials is another phase of the building problem that must often be passed upon by the business executive. Every type of construction has its particular advantages and disadvantages. Wood construction is cheaper as far

as initial cost is concerned. A wooden building can be quickly built and is easy to alter, but it is not fireproof, depreciates quickly, and is costly to maintain.

Concrete and steel construction or stone, brick, and steel construction are fireproof, depreciate slowly, will carry heavier loads, are easy to maintain, and usually allow for more window space. These types of construction are more costly at the outset and are difficult to alter or remove. It is evident that considerations of initial cost, the operations to be housed, and the permanency of the structure will largely determine the choice of material.

One of the features characterizing American commercial architecture at the present time is beauty in connection with serviceability. A well-laid-out office, store building, or factory can be made attractive as well as technically efficient. A distinctive or well-designed building usually has an advertising advantage which should not be overlooked by the business man.

6. *The measurement of building costs.*—A variety of units is used in measuring costs of construction, including the square foot, cubic foot, room, and square foot of net rentable area. If a factory is built in units, the unit cost can be used as the basis.

The following table shows the percentage of construction costs per square foot of net rentable area for an office building of economic height, where the ratio of the cost of the land to the cost of the building is approximately one to one:

Mechanical equipment	30.1%
Interior finish	17.4
Structural steel	12.5
Miscellaneous	11.3
Tenant's changes	6.4
Concrete floors	5.7
Brickwork	4.7
Exterior finish	4.6
Excavation and foundation	4.1
Permanent partitions	3.2

It is not advisable to present tables of material costs, since they vary from year to year and for different localities. As a rule, materials represent about 65 per cent of the total construction cost and labor about 35 per cent.

7. *Types of expert assistance available for planning.*—Since the business executive cannot usually be his own architect and builder, he must rely upon experts in those fields to guide him in formulating policies that will be of assistance to him in building construction.

The architect is, of course, an indispensable adviser. Knowledge of stresses and strains, of strength of materials, of kinds of materials, of architectural design, layout, appointments, and plans makes possible the modern building. The business man not only relies upon the architect for preliminary data, rough sketches, and working drawings, but also to approve contracts for construction, to supervise and check its progress, and to protect him against fraud and inferior work.

The American Institute of Architects has adopted a uniform contract which covers all of the relationships between architects and builders. The fee charged by an architect is based upon the total cost of doing the work. It is fixed by the American Institute of Architects at a minimum of six per cent of the cost of the job. The fee is usually payable as the work progresses.

The building manager, because of his continuous contacts with problems of service, floor plan, maintenance, and repairs, can give valuable advice respecting mechanical equipment, construction materials, efficiencies of layout, and structural standards. The planning and production departments of manufacturing concerns are vitally interested in laying out the factory so that the flow of work in progress can be facilitated, and are, therefore, the logical experts to advise the executive on new factory plans.

Structural and industrial engineers are occasionally called upon to furnish a solution to some technical structural problem or to some problem of layout or of architectural design. During the course of construction of one of the Federal Reserve banks, for example, the excavation and foundation contractors found that an old stream or spring crossing the property made it almost impossible to get a firm foundation, and it was necessary to call in a foundation engineer to help solve the problem.

8. *Other types of service for completing a building program.*—The real estate broker assists a build-

ing construction program by assembling the plot, arranging for mortgage loans, renting the space and even managing the building after it is completed.

The lawyer, always the constant adviser of business executives in problems relating to real estate, passes on contracts of sale and on matters affecting titles. Contracts with architects and contractors are drawn or passed on by him. Suits for damages, foreclosure of mortgages, and mechanics' liens are all matters to be taken care of by the legal adviser.

The general contractor is in charge of the construction. Under him are the subcontractors, who do the actual construction work. The general contractor agrees to complete the building, according to specifications, within a certain time, for which he is to be paid the sum agreed upon in the contract. The owner may operate as a general contractor himself, and as such make the contracts with material men and subcontractors. This presupposes that the owner has the organization to supervise the construction and the experience to act as general contractor.

9. *The construction contract.*—A construction contract is very often drawn up by the architect, since he knows the specifications for the building. If so, it should be checked by a lawyer to see that there are no flaws and to ascertain exactly the liability and risk assumed by the builder.

There are three kinds of contracts which may be drawn up between owner and contractors. The first is a fixed price contract. Under its provisions, a

price is set to cover the contractor's estimates of what it will cost him to do the work, plus a profit on the contract. The advantage of this kind of contract is that the owner knows at the start exactly what the construction job is going to cost.

The second type of contract is a "cost plus" contract. The figure paid by the builder, in this case, is the cost of the construction, plus a percentage to the contractor for his services. Ten per cent is the usual profit given to the contractor. This type of contract tends to guard against inferior work, since the owner pays for all materials and labor. On the other hand, since the contractor is paid on the basis of cost, he may encourage extravagance in building.

The third type of contract is a limited "open-end" contract, which is a combination of the other two. The owner pays the cost of construction, plus a percentage to the contractor for his services, but in no event is the work to cost more than a set amount specified in the contract. This type has the advantages of both of the others.

There is one contingency which may result in added cost under any one of the three types of contracts. If an owner alters the plan of the building or any of the architect's specifications, the amount to be paid by him for this change will be the difference between the cost under the old and the new specifications. Alterations quite frequently add greatly to the cost of construction and should be avoided, as far as possible, by a thorough study of the plans before com-

mencing building. As can be seen by the table on page 305, tenants' changes alone amount to 6.4 per cent of the cost of construction.

10. *The problem of moving.*—Moving a business is often a Herculean task but, if properly and carefully planned, inconvenience and delay can be reduced to a minimum. A large floor plan of the new space should be prepared, with the location of departments and even of every piece of equipment clearly indicated. Pieces of cardboard representing each piece of equipment can be cut to scale and shifted around on the plan until they are properly fitted in place. Later, when the equipment is definitely located, the drawing may be completed and the cardboard pieces discarded.

The next step is to number each department and each piece of equipment, so that they may be properly placed when moved. The blue-print floor plans for the new space are numbered so as to correspond with the system of marking the equipment itself. In addition, signs may be put up in the new quarters to indicate the location of departments and equipment.

If a factory is being moved, it is often necessary to plan the moving so that the manufacturing process will progress without much delay. Departments may then be moved in the order of the flow of work, or if not in that order, in such succession as to cause as little delay as possible.

11. *Industrial housing.*—Industrial housing is primarily a problem of labor rather than of real

estate. Such a problem usually arises when there are not sufficient housing facilities available for the employees, with the result that the business is forced to supply living quarters. In such cases, it usually falls upon the real estate department to provide the housing.

In lumber or construction camps, where men without families are employed, the housing usually takes the form of large barracks or even of tents to accommodate two or three men each. In the industrial centers, where men with families are employed, suitable houses must be built. These houses may be rented to the employee or sold to him.

If the corporation does not provide housing for its employees, it may organize a building or savings and loan company to assist in financing homes. Building contractors who specialize in the construction of small homes are well equipped to handle the industrial housing problem. The U. S. Department of Labor has prepared several bulletins on industrial housing that give full information and plans for meeting this problem.

REVIEW

Describe the needs for space of various types of business. How may expansion be provided for?

What factors must be considered in arriving at the economic height of buildings?

List the items of building cost in the order of importance.

What agencies are at the service of the business man in solving his building problem?

Describe the three types of building contracts.

What is meant by industrial housing?

CHAPTER XXII

ACQUIRING AND FINANCING A HOME

1. *The business man's interest in home ownership.*
—While home ownership is not, in general, a real estate problem of the business, nearly every successful business man hopes to be the owner of a home in his own right. A home signifies security, better living conditions, and greater happiness. Furthermore, the business man is often interested in the purchase, sale, construction, and financing of apartment houses. He looks on the purchase of an apartment house or a coöperative apartment as a good investment.

As a citizen, interested in promoting the welfare of community and nation, the business man realizes the importance of increasing the number of home owners, both directly, through his own ownership of a home, and indirectly, through his opportunities of making such ownership easier for others. This viewpoint has been forcefully presented by President Hoover, in a statement made while he was still Secretary of Commerce:

Maintaining a high percentage of individual home owners is one of the searching tests that now challenge the people of the United States. . . . Happily, a large section of

the people is awake to the problem, and an increasing number of business groups have publicly acknowledged their responsibility and interest in it. They realize that unnecessary barriers that may encompass a man determined to own his home are hindrances to good community spirit and to good business. They see that taking a neighborly interest in developing sound financing and other machinery for the use of home seekers, and insisting on the observance of honest, straightforward methods by those who deal with home seekers is not paternalism but good business and good citizenship. It is the "square deal"—and it is not only right but essential that the cards should not be stacked against the home seeker.

2. *Some preliminary problems.*—The first consideration confronting the prospective home owner is whether it is advisable for him to acquire his own home at this particular time. Even though the money should be available, the conditions of his employment may be such that the owner might be forced to move to some other city within a relatively short time. Furthermore, a home may not be a particularly good investment, because of local conditions, at the time the prospective buyer is considering a purchase.

Assuming that the time is ripe for undertaking the ownership of a home, the next consideration is the amount that should be set aside for the venture. Not more than three times the yearly income, under ordinary circumstances, should be invested in a dwelling place. If that figure will not buy a suitable home, or if the buyer has not accumulated in the neighborhood of 20 per cent of the purchase price, it would be better to postpone the investment.

One of the chief arguments advanced by those who sell houses is that it is cheaper to own than to rent. This is not always true. In addition to the various expenses of ownership, including insurance, taxes, interest on the mortgage, and maintenance, allowance must be made for the fact that a house is an investment, and that the owner should consider himself entitled to a reasonable return thereon, say, six per cent. When this allowance has been made, it is not always cheaper to own. It is true, however, that a more convenient and more comfortable home can generally be had by buying rather than by renting.

The architectural tastes and preferences of the buyer frequently exceed the capacity of his purse, and tempt him to invest more heavily than is wise. He should consider very carefully whether or not he can get the kind of a home he wants with the money that he has available. It is poor policy to discount the future too far in advance, because sickness, children, and the incidental expenses of home ownership are usually more than are anticipated at the start.

It has been well said that "a home should not only be a home in the truest sense of the word, but it should also be a sound investment." Expensive and elaborate homes are not, as a general rule, good investments. Financial institutions readily lend on property when its value runs from five to twenty thousand dollars, but less readily, when higher.

Is it cheaper to build than to buy? This question

cannot be answered in general, since each case is a particular one. A good procedure is for the buyer to ask himself whether he can get what he wants without building. In comparing figures on the relative costs of building and buying, one should remember that the building cost is more likely to exceed the original estimate than is the buying cost. Even so, partially improved homes may also be expensive because of additional landscaping, special assessments, and other incidentals.

3. *Aids to the prospective owner.*—Whether the prospective owner intends to build or buy, it is, in either case, a good plan to inspect houses that are being built or that have just been finished, so that he may see something of the detailed process of construction. The intending owner should know the more important facts about building costs, types of architecture, good locations for homes, materials, and financing, and something, also, of the sources of information and of the organizations and institutions that are available for assisting him in home planning.

The architect and the builder are first on the list of those who can advise on home planning. Manufacturers of building materials, of builders' supplies, and of household equipment can also assist. The Architects' Small House Service Bureau, the lumber companies, the large mail-order houses selling ready-cut homes, and the various magazines and papers devoted to home planning are reliable sources of in-

formation on home design, construction, and financing.

Every prospective home owner needs an architect as an adviser, and as a guardian against the ugliness and waste which so often result from unsound and ill-advised building schemes. The services of the architect include advice on such matters as type of architecture, plan, arrangement of layout so as to secure a maximum of usable space conveniently arranged, and the choice of built-in conveniences. He furnishes adequate detailed drawings for the contractor, which show every construction step and every interior and exterior detail, together with specifications for materials. No matter how small the house, the services of the architect are indispensable. A picture or a floor plan from a magazine becomes a reality only after being converted into working drawings by an architect, and after being properly built, according to specifications, by a builder who knows his business.

Many of the plans that may be secured without charge prove to be expensive after construction has been begun, owing to the extras and changes that usually are found necessary. As an alternative to the services of an architect, however, it is safe to buy plans from organizations providing a complete plan service, such as the Architects' Small House Service Bureaus. These are non-profit-making organizations controlled by the American Institute of Architects, and indorsed by the U. S. Department of Commerce.

4. *The probable cost of a home.*—Land and building costs vary in different localities, but it can be said, in general, that not much of a home can be obtained anywhere for less than \$3,000. Any home that costs more than \$50,000 is in the expensive class, and is very difficult to dispose of quickly if the owner is forced to sell.

The builder's estimates of costs, or the prices asked by real estate agents, may be checked up by reference to standard tables showing the cubic foot cost of various types of buildings, although these costs vary considerably from one state to another. The advice of a disinterested third party should be secured, preferably someone who is familiar with comparative property values in the community and experienced in some, at least, of the appraisal methods described in Chapters IV and V.

Since financial institutions determine the amount that they will lend on a property only after making a careful estimate of its value, their decisions may be used as a criterion by the prospective buyer or builder. If a reliable building and loan association, for example, refuses to lend more than 40 per cent of the price asked for a property, the buyer may assume that the price is too high. When the property is correctly priced, financial institutions will usually lend 50 per cent of the valuation put upon it, and in some instances as much as 60 per cent.

The cost of the lot, apart from the house, will de-

pend upon whether or not it has been improved. If all improvements have been made, such as street paving, curbing, sidewalks, water, electric, gas, and sewerage connections, the cost of the lot should not exceed 25 per cent of the total cost although it will frequently amount to as much as 20 per cent. In cases where no improvements have been made, the lot should not cost more than 10 per cent of the total figure.

5. *Choosing a location.*—The factors determining a good residential property are numerous and varied. Perhaps the first to consider is the present character of the neighborhood and the assurance, through proper restrictions, of its future character. A neighborhood that is wisely restricted will hold the desired residential atmosphere for a longer time than one which is not so protected.

If the community is not zoned, the prospective buyer will do well to inquire into the existence of private restrictions. This involves ascertaining whether there are restrictive clauses in the deeds for not only the house under consideration, but also for all other houses in the block. If even a single lot in the immediate neighborhood is unrestricted, an objectionable building might be erected on it. Private restrictions are frequently made to run for a definite number of years, and the home-seeker should make certain that the restrictions are not on the point of expiring.

The following outline, modified from a compila-

tion by the U. S. Bureau of Standards, calls attention to other important factors to be investigated before deciding upon a location:

(A) General location

- (1) Low or high land values
- (2) Transportation facilities
 - (a) To place of work
 - (b) To shopping centers
- (3) Protection offered to homes
 - (a) Private restrictions
 - (b) Zoning ordinances and city planning
 - (c) Fire protection
 - (d) Police protection

(B) Specific location

- (1) Character of the neighborhood
- (2) Accessibility to schools and playgrounds
- (3) Shade trees, shrubs, and planting
- (4) Set of house with reference to
 - (a) Sunlight
 - (b) Prevailing winds
- (5) Character of soil
- (6) Necessity for grading, filling, or draining
- (7) Improvements made or to be made
 - (a) Paving and curbing
 - (b) Water
 - (c) Gas and electricity
 - (d) Sewerage

6. *Architecture and materials.*—Common sense has been called an attribute of fine architecture. Good taste in the choice of a home is as obvious as good taste in dress, and both will emphasize convenience and comfort as primary considerations. American architecture is becoming as distinctive as

European, contrary to a popular opinion that most of our architecture is imitative, and that the colonial is the only true American type. It is true that many adaptations of the Spanish, English, Italian, Mediterranean, and Dutch styles of architecture abound, yet so much has been added to make the house meet the needs of home life in the United States that the result may be called truly American.

It is wise to choose building materials of a type that will fit into the general character of the neighborhood, and, if possible, add to its local color. Durability and upkeep are factors to be considered in addition to the initial expense of materials. Wood has the advantages of comparative cheapness and ease of handling. Its disadvantages are the danger from fire and the fact that the surface must be protected from the weather by painting every three or four years.

Solid brick is more fireproof and somewhat more expensive than brick veneer, but the latter is warmer in winter and cooler in summer. Brick veneer absorbs moisture, and it is necessary to use waterproof building-paper with the veneer to avoid damage to the interior finish and to prevent having a damp and unhealthful house. Laying brick veneer on hollow tile will also avoid much of this danger, since such a combination gives practically a solid masonry wall.

Stucco houses are built of wooden frame, hollow tile, or hollow concrete blocks, with three coats of

heavy cement plaster on the outside. If the house has a frame base, wire lath should be used to hold the plaster, rather than wood, which rots out very quickly. Stone is not used extensively in small houses, except for ledges and trim. Stone that has been cut in thin slabs may be used in house construction, but, like solid brick, it absorbs moisture.

The shingles should be chosen to fit in with the type of house, both as to material and color. Asbestos, asphalt, wood, slate, tile, or copper are available as materials for roofing.

7. *Forestalling poor construction.*—Many houses grow old before their time. This is evidenced by loose boards, curled shingles, cracked foundations, soft bricks, stains on bricks, cracked stucco, and sagged floors. These usually are the result of poor materials or of poor construction. The use of cheap materials may cause buildings to depreciate at the rate of five to ten per cent per year, instead of the standard two per cent. Without being extravagant in his choice, the home builder should not use poor materials, since they are certain to result in a risk to the investment.

One of the co-authors of this Text has fostered the building of better homes through using the "little more" appeal—the putting of "a little more" of thought, care, workmanship, material, and cost into the new home, and "a great deal more" of value. To point his appeal, he has addressed the following questions to his clients:

Do you know that there are innumerable grades and sizes of lumber; that building paper comes in three grades; that window and door frames are built of various qualities of lumber; that exterior trim should be painted before it is put up; that galvanized nails for roofs and wall boards are better than plain iron; that copper flashing is better than tin; that brass pipe lasts indefinitely and iron pipe does not; that copper leaders and gutters never have to be repaired; that shingles are graded from poor to perfect; that the proper proportion of cement and sand makes good mortar; and so on and so on?

An additional investment in better materials, when the house is built, costs more at the time but saves money, in the long run, through keeping down the cost of maintenance and the rate of depreciation.

8. *Watching the contractor.*—Regardless of the ethical standing and known reliability of the contractor who is chosen to build the house, the owner will do well to give much personal attention to the progress of construction. Mistakes are likely to be made, even under the best of contractors. After the house has been finished, it is too late to detect certain types of poor construction. On this point, the U. S. Bureau of Standards issues a pertinent warning:

In the completed house, the owner cannot determine the quality of certain materials or workmanship. For example, when a house is finished, he will not be able to inspect the quality of electric insulation, nor can he see whether or not there has been a proper nailing of studding, and bridging of joists, or if there is good fire stopping. Concealed parts cannot be seen and appraised after the building is erected. In part, the owner will have to rely upon examination of the quantity survey and the work of

the building inspector. It is easy to hide poor construction. The studding and the upper floor joists may be of very poor quality of lumber. Brickwork that is covered may conceal poor workmanship as well as defective brick. The quality of subfloors cannot be observed from an inspection of the completed building if the ceiling has been plastered or ceiled. For protection from shoddy work, the owner must depend upon the contractor, the architect, the building inspector, and his own observation during the period of construction.

9. *Financing the home.*—Few people, even though wealthy, buy or build entirely with cash. The mortgage is the ordinary basis of home financing. In some cases, it is a conservative first mortgage; in other cases, a first and second. On the other hand, the purchase may be effected by an installment contract, or a building and loan association may be relied upon to furnish the necessary means.

The savings banks, insurance companies, mortgage companies, and individuals are the usual sources of first-mortgage money. Second-mortgage money can be obtained from second-mortgage companies or from individuals. In many cases, the builder or the seller of the house takes back a purchase money or second mortgage as a part of the purchase price.

The down payment on a home usually amounts to 20 per cent of the purchase price. If a smaller amount is paid down, the carrying charges are correspondingly increased. Under ordinary circumstances, it is estimated that the average home purchaser can pay one per cent a month for the privilege of acquiring a home. This one per cent will pay for

the cost of the home in twelve years. If this scheme is followed, a \$10,000 house will cost \$100 per month to carry. These figures do not include taxes, insurance, or incidentals, but merely cover the cost of the financing and the repayment of the loan.

Most mortgages, even firsts, are obtained only at a discount of from three to ten or even twenty per cent, in addition to the six or six and one-half per cent rate. Houses are usually offered by the builder at a price that is about twice the cost of the house, since he must pay for the land, arrange for the financing, and frequently carry the house for some time before it can be sold, as well as allow for a fair return on his investment. The seller usually arranges the financing so that it is necessary for the purchaser to make only the down payment and show his ability to carry the mortgage.

Building and loan associations will normally lend more on property than will other lending institutions, partly because they are not as restricted by law, and partly because the loan is amortized monthly and is thus kept in a proper relation to the value of the property.

10. *Annual expense of financing.*—The U. S. Bureau of Standards has compiled a helpful table (reproduced on page 325) to show how the annual expense of financing will appear for small homes of different values. The figures are to be considered as typical only. It is assumed that the entire indebtedness will be cancelled in about twelve years,

if the payments given in the table are continued faithfully.

11. *Coöperative ownership*.—Interest in the co-operative ownership of apartment buildings and of single family residences arranged in groups has become widespread. Two forms of coöperative ownership are in use, the 100 per cent plan and the semi-coöperative. In the former plan, all of the apartments or houses are occupied by tenant owners; in the semi-coöperative plan, only part of them are so occupied. Where land values are high, as in the central districts of the larger cities, very few people can afford to, or care to, own a separate dwelling, but their desire for a secure and permanent home, free from increases in rental, is met by the coöperative plan.

12. *Plan of coöperative organization*.—It is most advisable to incorporate the coöperative apartment or group of dwellings and give to each tenant owner the amount of stock that represents his share in the corporation. At the same time, a 99-year lease, at a nominal rental, should be executed and turned over to the tenant. The stock ownership carries with it, accordingly, the right to occupy a certain apartment under a proprietary lease. The tenant may rent, sell, or redecorate his apartment, but, of course, he cannot tear it down. If he rents or sells, the new tenant must be acceptable to the management and to the other owners.

The most vital cog in the whole scheme of coöpera-

ANNUAL EXPENSE OF FINANCING SMALL HOMES

Cash Payment of 20 Per Cent of Total Value

	\$3,000 to 1,800	\$4,000 to 2,400	\$5,000 to 3,000	\$6,000 to 3,600	\$7,000 to 4,200	\$8,000 to 4,800	\$9,000 to 5,400	\$10,000 to 6,000
1. Value of house and lot.	\$3,000	\$4,000	\$5,000	\$6,000	\$7,000	\$8,000	\$9,000	\$10,000
2. Annual income.	{ 1,200 to 1,800	{ 1,600 to 2,400	{ 2,000 to 3,000	{ 2,400 to 3,600	{ 2,800 to 4,200	{ 3,200 to 4,800	{ 3,600 to 5,400	{ 4,000 to 6,000
3. First cash payment (20 per cent of value)	600	800	1,000	1,200	1,400	1,600	1,800	2,000
4. Amount of loan.	2,400	3,200	4,000	4,800	5,600	6,400	7,200	8,000
5. Interest and amortization (12½ per cent of loan)	300	400	500	600	700	800	900	1,000
6. Estimated taxes, insurance, and upkeep.	120	160	200	240	280	320	360	400
7. Total annual expenses.	\$420	\$560	\$700	\$840	\$980	\$1,120	\$1,260	\$1,400

tive ownership is efficient management. The tenants are the owners, but at the outset the property usually is turned over to a management company to operate during the life of the leases. Most of the coöperative enterprises that have gotten into difficulties have reached this situation because of laxity in management or because the spirit of coöperation was broken down by petty bickerings between the owners.

To be a success, the coöperative must be so managed that the saving and profits which usually go to a landlord will be passed on to the tenants. One function of the management is to allocate the costs of operation among the tenant owners in proportion to the value that each apartment bears to the value of the whole building. Employing a management company gives the tenants the advantage of the economies that a large organization can make through large-scale buying and large-scale operation. The management organizations have an engineering department for the purpose of taking care of improvements, maintenance and repairs, personnel, accounting, and purchasing.

13. *Advantages of coöperative ownership.*—One of the first advantages of coöperative ownership is the fact that it is usually cheaper to live in a coöperative apartment than to rent. A survey recently made of a group of high-class coöperative apartments showed that the average cost to tenants was from 20 to 40 per cent lower than for similar space in the

nearby non-coöperative apartment houses. This figure was arrived at after allowing a six per cent return to the tenant owner on his investment.

This saving to the tenant is effected because of certain economies. As a rule, vacancies are entirely eliminated. At the same time, there are no brokerage and rental expenses to be added to the total schedule of rents. The cost of redecoration is not as great, since there is not the steady turnover of tenants. The management of the coöperative apartments is under the direct control of the tenants, through their house committee. This committee must act through the management, but, in any event, the cost of service can be kept down and its character can be improved.

One of the chief advantages of living in a coöperative apartment, as compared with living in a private dwelling, is the convenience of having an organization to administer to the comfort and welfare of the tenants. The chief advantages over the non-coöperative apartment are the economy and the satisfaction of owning one's home.

14. *Financing the coöperative apartment.*—Two separate problems are involved in financing the coöperative apartment. The one is the financing of the construction and sale of the apartment house; the other is the financing of the purchaser of each separate apartment. The construction of the coöperative apartment is usually undertaken by some operator or group of operators who see the business

opportunities involved in its promotion. The plan is launched by acquiring a plot. The next step is to arrange for a first-mortgage loan to finance the construction of the house.

As a general rule, the lending institution puts up from 50 to 60 per cent of the investment cost of the property. The promoters put up enough to acquire the land and to start the scheme. Stock is then sold to equal the difference between the investment cost of the property and the amount of the mortgage. As soon as the stock is sold and the property turned over to the owning corporation, which is made up of the tenants, the promoters get their investment back and the profits thereon. The building is usually managed by some management firm connected with the operators or brokers who were instrumental in promoting the whole scheme.

The problem of financing the tenant who may not have enough money to buy his apartment outright is not quite as well standardized. Stock in a coöperative apartment, since it is not listed, is not considered good collateral by a bank for a loan. Some banks will lend on that type of security, but the sellers of the apartments more frequently will indorse the notes of tenants and thus negotiate a loan for the purchaser. In some instances, the promoters are strong enough, financially, to carry the stock for the tenant on a partial payment contract—a method which greatly facilitates the problem of financing the purchaser.

REVIEW

Name ten or twelve considerations of importance in choosing the location of a home.

Explain how the amount that a financial institution will lend on a property may be used to check up the reasonableness of the price being asked for it.

List some of the principal items in building construction that the prospective home owner should watch, to forestall poor workmanship.

Discuss the relative advantages in financing a home by the mortgage and the installment contract methods.

Describe the operating plan of a coöperative apartment building. How are coöperatives financed?

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